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## A. EXECUTIVE SUMMARY

### *Background*

Arthur Andersen LLP (AA) was engaged by the State of Maine Bureau of Insurance (the Bureau) to perform limited scope procedures in connection with the pending Form A (Statement Regarding the Acquisition of Control of a Domestic Insurer) application filing by Provident Companies, Inc. (Provident) and Hugh O. Maclellan, Jr. The Statement on Form A (Form A), dated January 7, 1999, seeks the approval of the Bureau of the proposed acquisition of control by merger of UNUM Life Insurance Company of America (UNUM America), a Maine-domiciled stock insurance company.

The general focus of our engagement was to provide analysis and assistance to the Bureau in its review of the pending Form A application filing (the filing). The specific requirements of our engagement, which are detailed in Section B of this report, related to the following areas:

- Business Plans of UNUM America and Provident Life and Accident Insurance Company (Provident Life) (together, the Companies), as filed with the Bureau
- Pooling of interests accounting treatment of the merger
- Tax free reorganization status of the merger
- Capital adequacy and risk based capital analysis in support of continuing operations
- Reserving methodologies and the development of the related assumptions of each of the Companies
- Historical dividend policies of the Companies and consideration of such on their respective Business Plans
- Selected market conduct areas such as complaints submitted to Provident Life relating to disability income claims

The following summarizes our observations, conclusions and recommendations by area:

### *Business Plans*

We reviewed several iterations of the Business Plans filed with the Bureau in connection with the Form A filing. The Business Plans related only to the standalone companies, UNUM America and Provident Life, as opposed to the merged entity, UNUMProvident. Thus, our analysis of the Business Plans was somewhat limited by the lack of a more macro view of the merger transaction and its impact on the combined Companies. With the exception of 1) the exclusion of dividends from both Company's Plans and 2) the high growth in premiums in UNUM America's Plan, which is not supported by historical trends, the Plans of both Companies, in general, appear reasonable. Additionally, both Business Plans reasonably account for the shift in new sales of group products from Provident

Life to UNUM America and new sales of individual products from UNUM America to Provident Life.

We recommend that the Bureau request that the Companies submit a UNUMProvident Business Plan prior to the consummation of the merger. We also recommend that the Bureau require the Companies to identify, quantify and track actual merger savings and expenses against the estimates provided to the Bureau and provide this analysis to the Bureau prior to the consummation of the merger and on a quarterly basis thereafter. We also recommend that the Bureau request a detailed reconciliation from UNUM America of the significant components of the increase in premiums, as reflected in its Business Plan.

#### *Pooling of Interests Accounting*

Based on our discussions with UNUM America management, UNUM's independent public accountants, PricewaterhouseCoopers, and the Bureau, as well as our review and analysis of the Agreement and Plan of Merger dated as of November 22, 1998, and Form S-4, we are not aware of any factors that would disqualify the use of the pooling of interests method of accounting for the proposed merger. Additionally, based on our review of certain SEC comment letters to UNUM and related correspondence, it is apparent that the SEC reviewed the pooling of interest accounting treatment.

Although certain future transactions during the two year period after the merger is consummated could retroactively disqualify the use of the pooling of interests method, we are not aware that any such transactions are contemplated. We recommend that the Bureau consider requiring UNUMProvident to provide periodic reporting to the Bureau of its ongoing compliance with the pooling of interests criteria over the two year period subsequent to the consummation of the merger.

#### *Tax Free Reorganization Analysis*

We were requested by the State of Maine Bureau of Insurance to provide our view of the taxability of the proposed transaction between UNUM Corporation and Provident Companies, Inc. based upon the facts and documentation provided, including legal opinions. We have not received sufficient information to determine whether the proposed UNUMProvident merger would meet the criteria for tax-free reorganizations under IRC §368(a). We have not received legal opinion letters from the Companies' counsel or a description of how the Companies intend to meet the requirements for a tax-free reorganization. Accordingly, we cannot express an opinion as to the taxability of this merger. However, the Companies have represented that it is their intention that the merger will be treated as a tax-free reorganization within the meaning of IRC Section §368(a). Based upon the information stated in the draft UNUM representation letter to Cravath, Swaine &

Moore (Exhibit D to the Merger Agreement), and the draft Provident representation letter to Sullivan & Cromwell (Exhibit E to the Merger Agreement), it is evident that the Companies intend to take the necessary steps to accomplish the transaction tax-free.

We recommend that the Bureau obtain the legal opinions of the Companies' counsel upon their issuance.

### *Capital Adequacy and RBC*

We performed actuarial calculations and analyses regarding Provident Life and UNUM America's reported Risk Based Capital (RBC) amounts as of December 31, 1998. Our calculations were consistent with the definitions of Risk Based Capital for Life and/or Health Insurers Model Act (the RBC Model Act) adopted by the National Association of Insurance Commissioners (NAIC) during December, 1992 and revised as of September, 1996. RBC represents a dynamic approach to regulatory measurement of the capital adequacy of life and health insurers. We also performed actuarial calculations and analyses regarding Provident Life and UNUM America based on parameters utilized by Standard & Poor's, Inc. to determine S&P Required Capital (SRC) and S&P Capital Adequacy Ratio (SPCAR) amounts.

Based on our limited-scope review, we conclude the following regarding UNUM America's and Provident Life's RBC and SPCAR amounts:

- Both UNUM America and Provident Life's RBC amounts and resulting RBC ratios as of December 31, 1998, as reported by the Companies, appear to be reasonably stated.
- UNUM America and Provident Life's RBC ratios (Adjusted Surplus divided by Company Action Level RBC) are estimated, as of December 31, 1998, at 190% and 188%, respectively, which are levels below industry averages (of roughly 250%) for comparably-sized companies, but within the range of RBC ratios (175% to 250%) considered "prudent" in the life insurance industry and with rating agencies.
- For UNUM America, we estimate that the combined effect of estimated merger expenses of approximately \$79.0 million and of an anticipated increase in disabled life reserves of approximately \$55 million would reduce UNUM America's RBC ratio as of December 31, 1998 from approximately 190% to approximately 168%, a level slightly below the range of levels considered "prudent" by the industry and by rating agencies.
- For Provident Life, we estimate that the combined effect of estimated merger expenses of approximately \$25.6 million would reduce Provident Life's RBC ratio as of December 31, 1998 from approximately 188% to approximately

180%, a level still within the range of levels considered "prudent" by the industry and by rating agencies.

- UNUM America's SPCAR amounts, as prepared by the Company, appear to modestly overstate the SPCAR. UNUM America calculated a SPCAR ratio of approximately 150%, whereas our recalculation of the SPCAR was approximately 146%. The overstatement results from an apparent omission of a certain item in the C-3 component of the S&P Required Capital (SRC) amount.
- For UNUM America, it appears that the combined effect of the merger expenses and the increased DLR would result, on a pro forma basis as of December 31, 1998, in a reduction in the SPCAR from 146% to 127%. On a stand-alone basis, this may have a negative effect on its "AA" S&P claims-paying ability rating. However, in addition to the effect of merger expenses and reserve increases, UNUM America's S&P claims-paying ability rating will likely be affected negatively (relative to their current AA rating) by the UNUMProvident merger, since Provident Life's capital adequacy (discussed below), as measured by S&P, is not as strong as UNUM America's.
- For Provident Life, it appears that the combined effect of the merger expenses would result, on a pro forma basis as of December 31, 1998, in a reduction in the SPCAR from 94% to 86%. On a stand-alone basis, this might have a negative effect on Provident Life's "A+" S&P claims-paying ability rating. However, in addition to the effect of merger expenses and reserve increases, Provident Life's S&P claims-paying ability rating will likely be affected positively (relative to their current A+ rating) by the UNUMProvident merger, since UNUM America's capital adequacy (discussed above), as measured by S&P, is stronger than Provident Life's.

### *Reserving Practices*

Based on our discussions with both UNUM America and Provident Life representatives, the methods used to calculate GAAP and statutory reserves for the significant lines of business of each Company appear to be comparable to methods typically used in the insurance industry for those lines of business. In addition, the process used to choose the underlying assumptions, as described by UNUM America and Provident Life representatives, also appears to be comparable to processes typically used in the insurance industry for those lines of business. However, due to the limited scope nature of our analysis, we cannot conclude regarding the reasonableness and appropriateness of the assumptions, or the reasonableness of the resulting UNUM America and Provident Life reserve values as of December 31, 1998.

We recommend that the Bureau consider:

- Performing a more in-depth analysis to determine whether the methods and assumptions used by both companies to calculate their respective GAAP and statutory reserves appear reasonable and appropriate and to determine whether the resulting values as of December 31, 1998 appear reasonably stated
- Monitoring the following reserve adjustments:
  - UNUM America's LTD Inventory Buildup Reserve Adjustment
  - UNUM America's Claim Operations Integration Reserve
  - Provident Life's Claims Disruption Reserve
- Performing a detailed analysis of UNUM America's change in GAAP DLR interest rate assumption at the time UNUM America determines the actual effect of the change in investment strategy.

### *Dividend Policies*

Based on an analysis of historical dividend payout trends and our review of the Business Plans of both UNUM America and Provident Life, we noted that both Companies did not include a dividend strategy or projection of the dividends to be paid. We recommend that the Bureau require the submission of a revised Business Plan that reflects the more likely scenario of dividends being paid, along with the submission of a dividend plan.

### *Market Conduct Analysis*

We noted several potential market conduct issues during our review of Provident Life's complaint register and complaint files. As a condition of the merger's approval, the Bureau may want to consider conducting a full-scope market conduct examination of UNUMProvident, placing particular emphasis on claims and complaint handling practices. The review should, at a minimum, include examination of disability income claims where benefits have been denied, suspended or terminated and claims where a "lump-sum settlement" was offered in lieu of continued benefits. The examination should be conducted within eighteen months of the merger.

Additionally, based on our findings, the Bureau may want to consider mandating some or all of the following as a condition of approval of the Form A filing:

UNUMProvident should:

- Develop and implement a written plan containing specific performance goals designed to achieve an effective and comprehensive compliance program. This plan should be presented to the Bureau within six months from the closing date of the merger. The Bureau should also require that the Company provide periodic updates of its progress relative to the achievement of these goals.

- Create and present to the Bureau a written claims procedures manual that includes compliance issues no later than six months from the closing date of the merger.
- Create and present to the Bureau a written appeals procedures manual that addresses all lines of business.
- Continue to perform compliance audits. These audits should include claims and complaints and be performed no less frequently than annually.
- Perform periodic audits of the activities of GENEX, its third party managed care company, to ensure appropriate, fair and compliant claims adjudication.
- Institute a procedure where each claim denial, suspension or termination letter contains language outlining the specific procedures to be followed should the claimant wish to appeal an adverse determination, as well as the credentials of the professionals involved in making the determination.
- Develop a system to ensure that complaints received outside the legal department are dated upon receipt by the Company.
- Develop a methodology to track and analyze verbal as well as written complaints.
- Update the Bureau regarding corrective actions taken relative to the findings in the compliance audit conducted in 1998 entitled, Complaint Management, within three months of the closing date of the merger.
- Evaluate the need to significantly expand the guidance in its Market Conduct Compliance Manual.



## B. SCOPE AND PROCEDURES

Arthur Andersen was engaged to perform the following procedures:

- A. Provide analysis and assistance to the Bureau in its review of the pending Form A filing by UNUM and Provident, including participation on behalf of the Superintendent in any public hearing, interim reports and advice, both written and oral and the preparation of a final written report.
- B. Provide independent analysis and assistance to the Bureau in evaluating the elements of the proposed transaction as further detailed below. The procedures shall include, but not be limited to, the following:
  - 1. Compare the most recent business plans filed by the Companies with historical trends to determine that the plans appear to be reasonable. In light of the fact that new sales of group products will be issued by UNUM America, determine that both plans account for this business shift.
  - 2. Provide a detailed explanation of the pooling of interests merger method being contemplated in the filing and the accounting impact of this method on the financial statements of UNUM and its subsidiaries.
  - 3. Provide a definition of tax free corporate reorganizations as contemplated in Section 368(a) of the Internal Revenue Code of 1986 as amended. Based upon the facts and documentation provided, including legal opinions from UNUM and Provident's counsel, provide your view of the taxability of the proposed transaction.
  - 4. Evaluate the adequacy of capital in support of continuing operations utilizing the standards outlined in the NAIC Risk Based Capital model as well as standards developed by Standard and Poor's Risk Based Capital model which is currently utilized by UNUM Corporation to maintain its "AA" rating.
  - 5. Discuss the underlying reserving assumptions and methodology with the Companies actuaries. Based on these discussions, compare the Companies reserving methodologies and the development of the assumptions with your knowledge of the industry in which the Companies compete. In areas where the Companies established miscellaneous reserve estimates, such as a claim integration reserve, obtain support from the Companies that satisfy you that these miscellaneous reserve estimates are appropriate.
  - 6. Evaluate the dividend policies utilized by UNUM and Provident both pre and post merger and determine if these policies are reflected in the business plan.

7. Review the filing and address issues relating to market conduct activity and claims practices of Provident.
8. At the completion of the work, prepare a detailed report describing the procedures, observations, findings and evaluation of the items discussed above.

## 1. Business Plans

### Procedures

*Compare the most recent business plans filed by the Companies with historical trends to determine that the plans appear to be reasonable. In light of the fact that new issues of group products will be done on UNUM paper (policy forms), determine that both plans account for this business shift. In all instances above, provide a written synopsis of the findings in your final report.*

### *Background*

As support for the merger of Provident Companies, Inc. and UNUM Corporation, both UNUM Life Insurance Company of America (UNUM America) and Provident Life and Accident Insurance Company (Provident Life) filed Company-specific business plans with the Bureau. The initial Business Plans filed were compiled on a standalone basis and did not take into account the anticipated effects of the merger. The Companies were requested to resubmit their plans to reflect anticipated merger expenses and savings.

On May 11, 1999, UNUM America refiled their Business Plan to reflect the impact of the merger and on May 13, 1999, Provident refiled its Business Plan reflecting the merger effects. On May 21, 1999, Provident again revised its Business Plan to include a balance sheet reflecting the impact of the merger on Provident Life.

### *Observations*

We reviewed the Business Plans and analyzed them relative to the historical trends of each Company's financial performance over the last three years to determine that the Plans appear reasonable. Also, we analyzed the Business Plans to assess whether they reasonably reflect the shift in certain lines of business between the Companies (for example, to account for the fact that new sales of group products will be issued by UNUM America instead of Provident Life).

The Business Plans, however, are only for UNUM America and Provident Life as standalone entities, with no consideration for the other insurance and noninsurance operations of the Companies. Thus, the UNUM Provident combined financial statements presented herein will not represent the proposed merged entity because data from the other insurance and non-insurance subsidiaries is excluded. The combined capital and surplus of these two companies represent approximately 58% of the combined capital and surplus of the domestic U.S. insurance companies. UNUM America represents 75% of the total earned premium of UNUM's domestic U.S. insurance companies. Provident Life represents 51% of total earned premiums of Provident's domestic insurance companies. While we combined the Business Plans for illustrative purposes (see Exhibits A and B), our analysis was performed on the individual entities due to lack of sufficient information on a combined basis.

The following tables reflect the relative significance of each Company on the basis of the capital and surplus of the domestic insurance operations of each holding company:

UNUM Corporation  
Domestic U.S. Insurers Capital and Surplus  
December 31, 1998

UNUM Life Insurance Company of America	\$1,086,997	81.6%
First UNUM America Insurance Company	111,531	8.4%
Colonial Life and Accident Insurance Company	131,121	9.8%
Continental National Life Insurance Company	1,380	.1%
Continental International Life Insurance Company	<u>1,360</u>	<u>.1%</u>
Total Domestic Insurers	<u>\$1,332,389</u>	<u>100.0%</u>

Provident Companies, Inc.  
Domestic U.S. Insurers Capital and Surplus  
December 31, 1998

Provident Life and Accident Insurance Company	\$ 518,236	35.7%
Provident Life and Casualty Insurance Company	77,736	5.4%
Provident National Insurance Company	56,690	3.9%
Paul Revere Life Insurance Company	599,525	41.3%
Paul Revere Protective Life Ins Co	104,651	7.2%
Paul Revere Variable Annuity Ins Co	<u>94,789</u>	<u>6.5%</u>
Total Domestic Insurers	<u>\$1,451,627</u>	<u>100.0%</u>

The Business Plans, as revised, are relatively high level plans. Thus, our analysis was limited due to lack of more detailed information. Our review of the Provident Life Plan indicated that the assumptions appear reasonable and that the data reconciled between the different versions filed with the Bureau. The UNUM America data presented in the Plan was more difficult to reconcile and analyze due to changes in assumptions between Plan versions that do not appear to have been filed with the Bureau.

We reviewed the merger effects on the pro forma statements included in each Company's Business Plan. We reconciled the pro forma income statements before the effects of the merger to the pro forma income statements after the effects of the merger.

We reviewed the estimated merger expenses and savings presented in the revised Business Plans of both Companies. UNUM America will incur a relatively higher portion of the expenses as they transition to a functional organizational structure. Provident Life has already adopted this structure, therefore, in relation to UNUM America, their expenses are lower. For the same reason, UNUM America is expected

to realize a higher proportion of the savings. The larger portion of the savings is related to UNUM America's staff reductions that generate future savings, and to a lesser extent, savings from consolidating facilities and equipment, reduced banking and accounting service fees and estimated savings from the alignment of benefit and compensation plans of the two Companies. While we were not provided specific details and amounts of the estimated merger expenses and savings, the general nature of the expenses and savings appear reasonable.

UNUMProvident's total pre-tax merger-related expenses are estimated at \$234 million, of which \$32 million is for legal, accounting, investment banking and consulting fees that will be paid at the holding company level. The remaining expenses which will be allocated to the insurance companies, consist of employee severance and related costs, expenses related to the early retirement offer and exit costs for duplicate facilities and asset abandonments. Of the \$202 million remainder, UNUM America's costs are estimated at \$105 million.

	Estimated 1999 Pre-tax Merger Related Charges*				
	UNUM Provident Combined	UNUM Statutory Companies	Provident Statutory Companies	UNUM America	Provident Life
	(\$ millions)				
Employee related expenses**	\$ 56.0	\$43.0	\$13.0	\$32.6	\$ 7.0
Early retirement offer	94.0	69.7	24.3	52.7	13.1
Exit costs for duplicate facilities/asset abandonment	52.0	26.0	26.0	19.7	14.0
Investment banking, legal and accounting fees	32.0	-	-	-	-
Total Restructuring Costs	\$234.0	\$138.7	\$63.3	\$105.0	\$34.1

\*Expenses are estimates and are subject to change.

\*\*Employee related expenses include employee severance costs, restricted stock costs and outplacement costs to assist employees who have been involuntarily terminated.

The table below highlights the major categories of estimated expense savings that are expected in UNUM America and Provident Life. Savings estimates assume the merger is consummated on June 30, 1999.

	Estimated Pre-tax Merger-Related Savings		
	1999	2000	2001
	(\$ millions)		
UNUM America			
Staff reduction savings	\$ 26.7	\$ 67.0	\$ 79.5
Non-recurring items*	15.0	-	-
Other office expenses	23.0	19.0	17.5
UNUM America savings	64.7	86.0	97.0
Provident Life			
Staff reduction savings	8.5	14.4	17.1
Other office expenses	6.8	6.9	4.2
Provident Life savings	15.3	21.3	21.3
Total	\$80.0	\$107.3	\$118.3

\*Non-recurring items include advertising and outside consulting fees.

	Estimated Job Eliminations by Company		
	June 30, 1999	December 31, 2000	December 31, 2001
UNUM America	298	632	935
Provident Life	76	161	238
All other	157	332	492
Total	531	1,125	1,665

Both Business Plans reasonably account for the shift in new sales of group products from Provident Life to UNUM America.

Neither UNUM America nor Provident Life included dividends in its pro forma financial statements, which given historical patterns, does not appear to be a reasonable assumption. This is discussed in more detail in Section 6 of this report.

We also noted that the percentage increase in earned premiums for UNUM America in its Business Plan, excluding the effects of the merger, were higher than historical trends, having increased from approximately 6% in 1998 to approximately 16% in 1999 and subsequent years.

### *Conclusion*

With the exception of 1) dividends being excluded from both Companies' Business Plans and, 2) the higher than expected premium growth in UNUM America's Plan relative to its historical growth trends, the Plans, in general, appear reasonable.

We recommend that the Bureau request that the Companies submit a UNUMProvident Business Plan prior to the consummation of the merger. We also recommend to the Bureau that they require the Company identify, quantify and track actual savings and expenses against the estimates provided to the Bureau and provide this analysis to the Bureau prior to the consummation of the merger and on a quarterly basis thereafter. Additionally, we recommend that the Bureau request a detailed reconciliation from UNUM America of the significant components of the increase in premiums as reflected in its Business Plan.

**EXHIBIT A**  
**UNUM Life Insurance Company of America**  
**Statutory Income Statement Variation Analysis**  
(in millions)

	Actual Results			Proforma After Effects of Merger							
	1996	1997	1998	1999	2000	2001					
Premiums, deposits and fees	\$2,335	1.4%	\$2,368	3.5%	\$2,451	16.7%	\$2,859	19.8%	\$3,424	19.2%	\$4,082
Net investment income including IMR amortization	651	-22.5%	504	-5.1%	479	5.5%	505	6.5%	538	7.4%	578
Release of previously deferred reinsurance gains		N/A	0	N/A	0	N/A	5	-20.0%	4	0.0%	4
Benefit payments including dividends to policyholders	1,835	-6.5%	1,716	10.0%	1,888	3.0%	1,945	12.2%	2,183	13.2%	2,471
Increase in insurance liabilities reserves and deposits	(373)	-108.3%	31	265.7%	113	236.3%	380	23.9%	471	32.9%	626
Commissions including reinsurance allowances (net)	262	8.6%	285	9.1%	310	0.5%	312	20.2%	375	18.7%	445
Premium taxes	69	-12.3%	61	24.3%	75	-24.3%	57	19.3%	68	19.1%	81
Expenses	999	-42.5%	574	-4.6%	547	19.2%	652	-5.7%	615	13.7%	699
Pre-tax operating gain	194	6.5%	206	-102.1%	(4)	-634.9%	23	1004.3%	254	34.6%	342
Income taxes	80	-70.3%	24	-169.3%	(17)	-21.2%	(13)	-484.6%	50	102.0%	101
After tax operating gain	114	60.7%	182	-93.3%	12	195.1%	36	466.7%	204	18.1%	241
Realized capital gains net of tax	3	-228.1%	(4)	-19.5%	(3)	-584.8%	16	-100.0%	0	N/A	0
Increase (decrease) in net unrealized cap gain(loss)	3	-223.1%	(3)	-425.0%	10	-100.0%	0	N/A	0	N/A	0
Increase (decrease) in deferred gain on rein trans	157	-127.1%	(42)	-86.6%	(6)	-12.3%	(5)	-20.0%	(4)	0.0%	(4)
Increase (decrease) in not-admitted assets	(14)	-141.3%	6	-116.9%	(1)	300.0%	(4)	50.0%	(6)	33.3%	(8)
Surplus contribution (distribution to parent)	(179)	0.4%	(180)	-173.1%	132	-100.0%	0	N/A	0	N/A	0
Other capital and surplus changes	(26)	-203.1%	27	-110.5%	(3)	2328.6%	(68)	-100.0%	0	N/A	0
Net change in capital & surplus & AVR	\$56	-126.1%	(\$15)	-1061.2%	\$141	-117.7%	(\$25)	-876.0%	\$194	18.0%	\$229



**EXHIBIT A**  
**Provident Life and Accident Insurance Company**  
**Statutory Income Statement Variation Analysis**  
(in millions)

	Actual Results			Proforma After Effects of Merger							
	1996	1997	1998	1999	2000	2001					
Premiums, deposits and fees	\$1,298	-3.0%	\$1,259	6.6%	\$1,342	1.6%	\$1,364	1.9%	\$1,390	0.6%	\$1,399
Net investment income including IMR amortization	945	-5.3%	895	-6.2%	840	-1.0%	831	1.3%	842	4.4%	879
Release of previously deferred reinsurance gains	26	157.8%	68	-47.5%	36	-10.1%	32	-6.3%	30	-3.3%	29
Benefit payments including dividends to policyholders	2,169	18.7%	2,576	-13.8%	2,220	-49.1%	1,130	1.7%	1,149	-1.8%	1,128
Increase in insurance liabilities reserves and deposits	(449)	96.9%	(884)	-50.0%	(442)	-211.1%	491	0.0%	491	9.2%	536
Commissions including reinsurance allowances (net)	164	4.2%	170	-1.5%	168	9.0%	183	7.1%	196	4.6%	205
Premium taxes	40	-8.0%	37	14.4%	42	-7.6%	39	2.6%	40	0.0%	40
Expenses	173	12.9%	195	11.2%	217	11.2%	241	-13.3%	209	-4.3%	200
Pre-tax operating gain	173	-26.0%	128	-89.8%	13	1000.0%	143	23.8%	177	11.9%	198
Income taxes	75	-19.4%	61	-120.0%	(12)	-637.2%	65	18.5%	77	9.1%	84
After tax operating gain	97	-31.0%	67	-62.6%	25	210.8%	78	28.2%	100	14.0%	114
Realized capital gains net of tax	5	-657.4%	(30)	-70.1%	(9)	-100.0%	0	N/A	0	N/A	0
Increase (decrease) in net unrealized cap gain(loss)	(0)	1533.3%	(5)	26.5%	(6)	-100.0%	0	N/A	0	N/A	0
Increase (decrease) in deferred gain on rein trans		N/A	0	N/A	0	N/A	0	N/A	0	N/A	0
Increase (decrease) in not-admitted assets	(5)	158.0%	(13)	-254.3%	20	-100.0%	0	N/A	0	N/A	0
Surplus contribution (distribution to parent)	(42)	124.9%	(95)	-30.3%	(66)	-100.0%	0	N/A	0	N/A	0
Other capital and surplus changes	(31)	-138.4%	12	401.7%	60	-100.0%	0	N/A	0	N/A	0
Net change in capital & surplus	\$24	-362.1%	(\$64)	-136.7%	\$23	233.3%	\$78	28.2%	\$100	14.0%	\$114

**EXHIBIT A**  
**Provident and UNUM**  
**Combined Statutory Income Statement Variation Analysis**  
(In millions)

	Actual Results			Proforma After Effects of Merger							
	1996	1997	1998	1999	2000	2001					
Premiums, deposits and fees	\$3,633	-0.2%	\$3,627	4.6%	\$3,793	11.3%	\$4,223	14.0%	\$4,814	13.9%	\$5,481
Net investment income including IMR amortization	1,596	-12.3%	1,399	-5.8%	1,318	1.4%	1,336	3.3%	1,380	5.6%	1,457
Release of previously deferred reinsurance gains	26	157.8%	68	-47.5%	36	3.9%	37	-8.1%	34	-2.9%	33
Benefit payments including dividends to policyholders	4,004	7.2%	4,292	-4.3%	4,107	-25.1%	3,075	8.4%	3,332	8.0%	3,599
Increase in insurance liabilities reserves and deposits	(821)	3.8%	(853)	-61.4%	(329)	-364.7%	871	10.4%	962	20.8%	1,162
Commissions including reinsurance allowances (net)	426	6.9%	455	5.1%	478	3.5%	495	15.4%	571	13.8%	650
Premium taxes	109	-10.7%	98	20.5%	118	-18.3%	96	12.5%	108	12.0%	121
Expenses	1,171	-34.4%	769	-0.6%	764	16.9%	893	-7.7%	824	9.1%	899
Pre-tax operating gain	366	-8.8%	334	-97.4%	9	1808.0%	166	159.6%	431	25.3%	540
Income taxes	155	-45.7%	84	-133.9%	(29)	-281.8%	52	144.2%	127	45.7%	185
After tax operating gain	211	18.3%	250	-85.1%	37	205.6%	114	166.7%	304	16.8%	355
Realized capital gains net of tax	9	-497.7%	(34)	-64.0%	(12)	-230.1%	16	-100.0%	0	N/A	0
Increase (decrease) in net unrealized cap gain(loss)	2	-452.2%	(8)	-151.9%	4	-100.0%	0	N/A	0	N/A	0
Increase (decrease) in deferred gain on rein trans	157	-127.1%	(42)	-86.6%	(6)	-12.3%	(5)	-20.0%	(4)	0.0%	(4)
Increase (decrease) in not-admitted assets	(19)	-63.7%	(7)	-370.0%	19	-121.2%	(4)	50.0%	(6)	33.3%	(8)
Surplus contribution (distribution to parent)	(222)	24.1%	(275)	-123.8%	65	-100.0%	0	N/A	0	N/A	0
Other capital and surplus changes	(57)	-167.8%	39	47.4%	57	-219.5%	(68)	-100.0%	0	N/A	0
Net change in capital & surplus & UNUM AVR	\$81	-197.3%	(\$78)	-310.1%	\$165	-67.8%	\$53	454.7%	\$294	16.7%	\$343

**EXHIBIT B**  
**Provident Life and UNUM America**  
**Combined Statutory Balance Sheet Variation Analysis**  
**(in millions)**

	Actual Results			Proforma After Effects of Merger							
	1996	1997	1998	1999	2000	2001					
Invested assets	\$18,563	-8.1%	\$17,051	-2.5%	\$16,631	5.9%	\$17,610	7.1%	\$18,863	8.0%	\$20,375
Accounts receivable	509	7.8%	549	1.8%	559	96.4%	1,098	4.2%	1,145	4.7%	1,199
Other assets	109	22.4%	133	60.6%	214	13.2%	242	16.5%	282	16.7%	329
Total assets	\$19,181	-7.5%	\$17,733	-1.9%	\$17,404	8.9%	\$18,951	7.1%	\$20,290	7.9%	\$21,902
Insurance reserves and liabilities	\$16,581	-7.5%	\$15,332	-3.3%	\$14,825	8.9%	\$16,151	5.9%	\$17,098	6.7%	\$18,250
Other liabilities (excluding UNUM AVR)	965	-9.7%	871	1.2%	882	18.9%	1,049	9.4%	1,148	10.1%	1,264
Capital (including UNUM AVR)	1,635	-6.4%	1,530	11.0%	1,698	3.1%	1,751	16.8%	2,045	16.8%	2,389
Total liabilities and equity	\$19,181	-7.6%	\$17,733	-1.9%	\$17,404	8.9%	\$18,951	7.1%	\$20,290	7.9%	\$21,902

**EXHIBIT C**  
**UNUM Life Insurance Company of America**  
**Premium Growth Variation Analysis**  
(In millions)

	1994	1995	1996	1997	1998
Premiums & annuity considerations & fees	\$1,808	\$2,052	\$2,060	\$2,302	\$2,495
Deposit type funds	306	355	269	59	8
Supplementary contracts with life contingencies	1	1	0	1	1
Supplementary contracts w/o life contingencies	6	5	5	6	7
Total premiums, deposits and fees	<u>\$2,120</u>	<u>\$2,412</u>	<u>\$2,335</u>	<u>\$2,368</u>	<u>\$2,509</u>
Percentage change of premiums, deposits and fees	<u>N/A</u>	<u>13.8%</u>	<u>-3.2%</u>	<u>1.4%</u>	<u>6.0%</u>

	Before Effects of Merger		After Effects of Merger		Merger Effects	
	1999	2000	1999	2000	1999	2001
Premiums, deposits and fees	\$2,854	\$3,310	\$2,859	\$3,424	\$5	\$267
Percentage change of premiums, deposits and fees	16.4%	16.0%	16.6%	19.8%	0.2%	4.0%

**EXHIBIT D**  
**Domestic Insurers of UNUM Corporation**  
**Capital and Surplus**  
**1996, 1997, 1998**

	(\$000)					
	UNUM Life Ins. Co. of America	First UNUM Life Ins. Co	Colonial Life & Acc. Ins. Co.	Continent Nation. Life Ins.Co.	Continent Internat. Life	UNUM Group Total
Capital & surplus as of December 31, 1995	<u>\$905,003</u>	<u>\$121,922</u>	<u>\$122,013</u>	<u>\$1,234</u>	<u>\$1,197</u>	<u>\$1,151,369</u>
Net income	116,404	13,663	39,818	42	41	169,968
Change net unrealized capital gain (loss)	2,606	1,956	-			4,562
Change non-admitted assets	(14,306)	(3,258)	(593)			(18,157)
Change liab for reins in unauth cos	(14)	8	-			(6)
Change reserve - valuation basis	(15,141)	-	-			(15,141)
Change asset valuation reserve	39,255	(105)	(302)	(4)	(2)	38,842
Surplus adjustments: paid in	(179,301)	(15,000)	(46,000)			(240,301)
Dividends to stockholders	106,578	9,693	-			116,271
Net change in capital and surplus for 1996	<u>56,082</u>	<u>6,957</u>	<u>(7,076)</u>	<u>38</u>	<u>39</u>	<u>56,040</u>
Capital and surplus as of December 31, 1996	<u>961,085</u>	<u>128,879</u>	<u>114,936</u>	<u>1,271</u>	<u>1,236</u>	<u>1,207,407</u>
Net income	177,853	15,965	28,304	42	(42)	222,122
Change net unrealized capital gain (loss)	(3,282)	(485)	-			(3,767)
Change non-admitted assets	5,958	3,514	4,597			14,069
Change liab for reins in unauth cos	798	(194)	-			604
Change reserve - valuation basis	-	-	-			-
Change asset valuation reserve	26,074	3,244	1,465	24	42	30,849
Surplus adjustments: paid in	(180,000)	(40,000)	(24,000)			(244,000)
Dividends to stockholders	(42,454)	(1,173)	-			(43,627)
Aggregate write-in for gain (loss) in surplus	<u>(15,053)</u>	<u>(19,129)</u>	<u>10,366</u>	<u>65</u>	<u>(1)</u>	<u>(23,752)</u>
Net change in capital and surplus for 1997						
Capital and surplus as of December 31, 1997	<u>946,032</u>	<u>109,749</u>	<u>125,303</u>	<u>1,337</u>	<u>1,235</u>	<u>1,183,656</u>
Net income	22,313	2,110	41,474	43	40	65,980
Change net unrealized capital gain (loss)	(3,400)	42	-			(3,358)
Change non-admitted assets	(1,010)	121	(11,643)			(12,532)
Change liab for reins in unauth cos	-	(12)	-			(12)
Change reserve - valuation basis	693	(210)	-			483
Change asset valuation reserve	(3,428)	216	(1,013)	(1)		(4,226)
Surplus adjustments: paid in	160,000	-	-			160,000
Dividends to stockholders	(28,500)	-	(23,000)			(51,500)
Aggregate write-in for gain (loss) in surplus	<u>(5,703)</u>	<u>(485)</u>	<u>-</u>		<u>85</u>	<u>(6,103)</u>
Net change in capital and surplus for 1998	<u>140,965</u>	<u>1,782</u>	<u>5,818</u>	<u>43</u>	<u>124</u>	<u>148,732</u>
Capital and surplus as of December 31, 1998	<u>\$1,086,997</u>	<u>\$111,531</u>	<u>\$131,121</u>	<u>\$1,380</u>	<u>\$1,360</u>	<u>\$1,332,389</u>

**EXHIBIT D**  
**Domestic Insurers of Provident Companies, Inc**  
**Capital and Surplus**  
**1996, 1997, 1998**

(\$000)

	Provident Life and Acc. Ins. Co.	Provident Life and Casualty Ins. Co.	Provident National Assurance Co.	Paul Revere Life Ins. Co.	Paul Revere Protective Life Ins. Co.	Paul Revere Variable Annuity Ins. Co.	Provident Group Total
Capital & surplus as of December 31, 1995	<u>\$535,436</u>	<u>\$43,670</u>	<u>\$159,923</u>	<u>\$375,642</u>	<u>\$95,509</u>	<u>\$66,526</u>	<u>\$1,276,706</u>
Net income	102,248	5,449	(2,808)	(138,959)	17,636	12,450	(3,966)
Change net unrealized capital gain (loss)	(361)	-	27	58,686	4,308	3,920	66,580
Change non-admitted assets	(5,090)	39	(7,200)	1,566	-	18	(10,667)
Change liab for reins in unauth cos	366	-	-	227	-	-	593
Change reserve - valuation basis	(10,070)	(1,014)	-	-	-	(3,355)	(14,439)
Change asset valuation reserve	(15,327)	(174)	17,375	(9,921)	2,906	-	(5,141)
Surplus adjustments: paid in	-	-	(89,664)	108,500	-	-	18,836
Surplus adjustments: result of reinsurance	-	-	-	(54,631)	45,981	-	(8,650)
Dividends to stockholders	(42,265)	-	(10,336)	-	-	(8,000)	(60,601)
Aggregate write-in for gain (loss) in surplus	(6,047)	-	-	4,817	-	1,024	(206)
Net change in capital and surplus for 1996	<u>23,452</u>	<u>4,300</u>	<u>(92,606)</u>	<u>(29,715)</u>	<u>70,821</u>	<u>6,057</u>	<u>(17,691)</u>
Capital and surplus as of December 31, 1996	<u>558,887</u>	<u>47,970</u>	<u>67,317</u>	<u>345,927</u>	<u>166,330</u>	<u>72,583</u>	<u>1,259,014</u>
Net income	36,479	26,318	7,036	(36,289)	26,361	17,522	77,427
Change net unrealized capital gain (loss)	(4,973)	-	-	22,500	(10,657)	(11,045)	(4,175)
Change non-admitted assets	(12,569)	(145)	4,871	(2,044)	(7)	70	(9,824)
Change liab for reins in unauth cos	179	-	-	(4)	-	-	175
Change reserve - valuation basis	(8,018)	(131)	(5,000)	(48)	(1,758)	(611)	(15,566)
Change asset valuation reserve	26,567	2,730	9,990	17,892	5,273	13,249	75,701
Surplus adjustments: paid in	-	-	-	42,500	-	-	42,500
Surplus adjustments: result of reinsurance	-	-	-	(1,969)	-	-	(1,969)
Dividends to stockholders	(94,905)	(5,000)	(10,000)	-	-	(2,000)	(111,905)
Aggregate write-in for gain (loss) in surplus	(6,780)	-	-	98,942	-	-	92,162
Net change in capital and surplus for 1997	<u>(64,020)</u>	<u>23,772</u>	<u>6,897</u>	<u>141,480</u>	<u>19,212</u>	<u>17,185</u>	<u>144,526</u>
Capital and surplus as of December 31, 1997	<u>494,867</u>	<u>71,742</u>	<u>74,214</u>	<u>487,408</u>	<u>185,542</u>	<u>89,769</u>	<u>1,403,542</u>
Net income	16,173	(187)	3,091	112,817	24,216	43,338	199,448
Change net unrealized capital gain (loss)	(6,270)	-	-	15,675	718	(244)	9,879
Change non-admitted assets	19,931	27	3,455	(541)	-	(1,367)	21,505
Change liab for reins in unauth cos	-	-	-	(2,464)	-	-	(2,464)
Change reserve - valuation basis	69,786	7,247	929	(735)	(5,788)	(2,319)	69,120
Change asset valuation reserve	(2,337)	(1,094)	-	(11,718)	(37)	8,844	(6,342)
Surplus adjustments: paid in	-	-	(13,281)	-	(100,000)	-	(113,281)
Surplus adjustments: result of reinsurance	-	-	-	4,444	-	15,768	20,212
Dividends to stockholders	(66,170)	-	(11,719)	-	-	(59,000)	(136,889)
Aggregate write-in for gain (loss) in surplus	(7,745)	-	-	(5,363)	-	-	(13,108)
Net change in capital and surplus for 1998	<u>23,368</u>	<u>5,994</u>	<u>(17,524)</u>	<u>112,117</u>	<u>(80,891)</u>	<u>5,020</u>	<u>48,084</u>
Capital and surplus as of December 31, 1998	<u>\$518,236</u>	<u>\$77,736</u>	<u>\$56,690</u>	<u>\$599,525</u>	<u>\$104,651</u>	<u>\$94,789</u>	<u>\$1,451,626</u>

## 2. Pooling of Interests Accounting

### Procedures

*Provide a detailed explanation of the pooling of interests merger method being contemplated in the filing and the accounting impact of this method on the financial statements of UNUM and its subsidiaries.*

### *Background*

The pooling of interests method of accounting for business combinations treats the combination as the uniting of the ownership interests of two or more companies by exchange of equity securities. No acquisition is recognized because the combination is accomplished without disbursing resources of the combining companies. The stockholder groups neither withdraw nor invest assets, but, in effect, exchange voting common stock in a ratio that determines their respective interests in the combined corporation.

Based on the presence of certain criteria, a business combination transaction is either a purchase or a pooling of interests. There is not a choice between the two. The distinction between purchase and pooling affects all aspects of accounting for the transaction including the financial statements before and after the transaction.

A purchase is the acquisition of one entity by another by buying the assets and assuming the liabilities. Assets and liabilities are recorded at fair value. Goodwill equaling the excess of the purchase price paid (if applicable), which includes transaction costs, over the fair value of net assets is recognized and amortized into income over a period generally not exceeding 40 years. Under the pooling of interests method, the combining companies are accounted for as if there was always one combined entity. Assets and liabilities continue to be carried at book value. No adjustments are required or permitted (except in certain cases when adjustments are necessary to harmonize the accounting methods of the combining entities) and no goodwill is recorded. Transaction costs are expensed directly in a pooling arrangement.

In a transaction accounted for as a purchase, the income statement reflects the combined operations of the two entities from the date of purchase going forward. In a pooling of interests, prior periods are restated as if the entities had always been combined. Purchase transactions often increase the future costs of the combined entity because a higher asset base must be depreciated over the remaining life of the assets and any goodwill will be amortized over its estimated useful life. No such adjustments are applicable in a pooling of interests transaction.

The primary advantages of pooling of interests are:

- Less future depreciation/amortization
- Balance sheet is not increased by intangibles
- Restatement of prior periods results in comparable financial statements

There are twelve criteria that a transaction must meet in order to be accounted for as a pooling of interests. These criteria relate to the attributes of the combining companies, the nature of the transaction, and the absence of certain planned transactions. The following table lists those criteria and discusses whether or not the contemplated merger of UNUM Corporation (UNUM) and Provident Companies, Inc. (Provident), as stated in the Agreement and Plan of Merger dated November 22, 1998 (the Agreement), meets those criteria. A "Yes" answer in the "Is Criteria Met" column represents our best estimate of whether the required pooling criteria has been met based on our understanding of the transaction through reading the Agreement, Provident's Form S-4 filing (Form S-4) which became effective June 2, 1999 and discussions with the Bureau, UNUM management and UNUM's independent public accountants, PricewaterhouseCoopers (PWC). The Agreement contains representations that both Provident and UNUM have obtained opinions from PWC and Ernst and Young stating that they believe that the contemplated transaction qualifies as a pooling of interests.

<u>Pooling of Interests Criteria</u>		<u>Is Criteria Met?</u>	<u>Reference</u>
1.	Each entity is autonomous and has not been a subsidiary or division of the other within two years before the plan of combination is initiated (the earlier of the date major provisions are announced to public or formally made known to shareholders or the date that shareholders are notified in writing). <ul style="list-style-type: none"> <li>➤ A plan of combination is initiated on the earlier of (1) the date that the major terms of a plan, including the ratio of stock exchange, are announced publicly or otherwise formally made known to the stockholders of any one of the combining companies or (2) the date that stockholders of a combining company are formally notified of an exchange offer.</li> </ul>	Yes	Per review of Exhibit 21 of each Company's December 31, 1998 Form 10K and Form S-4



<u>Pooling of Interests Criteria</u>	Is Criteria Met?	<u>Reference</u>
<p>2. Each party must be independent of the other. As of the date of initiation, neither company may own more than 10% of the outstanding voting common shares of the other, and the value of any joint venture between the two may not exceed 50% of the estimated value of either of the combining parties.</p> <ul style="list-style-type: none"> <li>➤ Ownership of currently convertible securities or exercisable warrants that are at or in the money and that represent more than 10% of the "if converted" voting rights violates the independence requirement. The SEC staff has also indicated that independence may also be impaired by intercorporate holdings of securities that are deemed "essentially the same" as common stock, but are not currently exchangeable into voting common stock.</li> </ul>	Yes	Per review of Form S-4
<p>3. Must be a stock transaction. Common stock of the issuer is exchanged for substantially all (at least 90%) of the common stock of the combining company. The distinction between ownership interests disappears.</p> <ul style="list-style-type: none"> <li>➤ In certain instances, cash may be exchanged within limits as consideration for fractional shares or for the shares of dissenting shareholders. There may not be, however, any pro rata distributions of cash or other consideration.</li> <li>➤ The number of shares exchanged excludes those shares of the combining company, (1) acquired before and held by the issuing company and its subsidiaries at the date the plan of combination is initiated, regardless of the form of consideration, (2) acquired by the issuing enterprise and its subsidiaries after the date the plan of combination is initiated other than by issuing its own voting common stock, and (3) outstanding after the date the combination is consummated.</li> <li>➤ Each shareholder of the combining company must either agree to exchange all shares for common shares or refuse to exchange any shares.</li> </ul>	Yes	Page 1 of the Agreement and Form S-4 - All shares exchanged for equivalent shares of the combined entity

<u>Pooling of Interests Criteria</u>	<u>Is Criteria Met?</u>	<u>Reference</u>
<ul style="list-style-type: none"> <li>➤ The payment for fractional shares among shareholders must be reasonable in amount and should be proportional to each shareholder's fractional share interest.</li> <li>➤ In the absence of government regulation, no restriction can be imposed by the issuing corporation upon the sale of newly issued stock.</li> <li>➤ An investment in stock of the issuing enterprise held by a combining company may prevent a combination from meeting this condition even though the investment of the combining enterprise is not more than 10 percent of the outstanding stock of the issuing enterprise. Pooling of interest is precluded when the issuing company reacquires shares of its own stock held by the other combining company in a combination and those shares exceed 10% of that company's outstanding shares after equating the shares of the combining companies based on the exchange ratio in combination.</li> <li>➤ If outstanding debt and equity securities other than common stock of the acquired company were issued in exchange for voting common stock of that company for a period of two years prior to the initiation of combination, the issuing company must issue voting common stock for these securities.</li> </ul>		
<p>4. Combination must be effected in a single transaction or in accordance with a specific plan within one year of initiation (date of consummation is the date that the parties substantively exchange consideration specified in the combination. This date does not necessarily coincide exactly with the legal closing.)</p> <ul style="list-style-type: none"> <li>➤ The only exception is if governmental action or litigation causes the delay.</li> <li>➤ Altering the terms of exchange of stock constitutes initiation of a new plan of combination unless earlier exchanges of stock are adjusted to the new terms.</li> <li>➤ If there is a "preliminary closing" and less than a majority of the shares are issued, those shares cannot be disposed of prior to the final closing.</li> </ul>	Yes	Page 4 Section 2.01 (b) of the Agreement, Transaction consummated at the "Effective Time"

<u>Pooling of Interests Criteria</u>	Is Criteria Met?	<u>Reference</u>
<p>5. Neither of the combining companies may change the equity interest of the voting common stock in contemplation of effecting the combination either within two years before the plan of combination is initiated or between the dates the combination is initiated and consummated; changes in contemplation of effecting the combination may include distributions to stockholders, additional issuances, exchanges and retirements of securities.</p> <ul style="list-style-type: none"> <li>➤ Distributions to stockholders which are no greater than normal dividends are not changes for this condition. Normality of dividends is determined in relation to earnings during the period and to the previous dividend policy and record. Dividend distributions on stock of a combining company that are equivalent to normal dividends on the stock to be issued in exchange in the combination are considered normal for this condition.</li> <li>➤ If the combining company grants the acquiring company a "crown jewel" option to buy a prized asset or subsidiary for no monetary or other consideration, and the option expires unexercised, pooling accounting would be allowed.</li> <li>➤ If one or both parties to a proposed merger grant the other party options to buy shares of their common stock at a fixed price, and the options expire unexercised, the merger could be accounted for as a pooling.</li> <li>➤ If one or both parties issue shares to the other party for cash, pooling accounting would be precluded since this would be an alteration of equity interests. If shares are issued for shares and they represent more than 10 % of the outstanding common stock, the companies would not be considered independent.</li> <li>➤ A call to force conversion of convertible securities would not preclude pooling as long as the call was in accordance with the terms of the securities, but a "sweetener" or other inducement within two years prior to a combination would be presumed to be an alteration of equity interests.</li> </ul>	Yes	Based on discussions with PWC; also, nothing came to our attention, from our review of various documents, that would violate this criterion

<u>Pooling of Interests Criteria</u>	<u>Is Criteria Met?</u>	<u>Reference</u>
<ul style="list-style-type: none"> <li>➤ The issuance of poison pill warrants or rights is not generally a change in equity interests, even if the poison pill was issued after initiation. Similarly, the reacquisition or retirements of such rights would not be viewed as a change in equity interests. However, if the pill is triggered by a takeover attempt, that takeover can't be a pooling, even if it later turns friendly.</li> <li>➤ Neither of the combining companies can sell nor dispose of a significant amount of assets in the period six to nine months preceding the pooling. However, disposals in the normal course of business would not normally preclude pooling.</li> </ul>		

*PWC specifically reviewed and analyzed UNUM's more recent asset/business dispositions or disposition plans, including Duncanson & Holt, indicating that this criterion was met.*

- Except for extraneous and non-operating assets, any spin -off of assets within two years of a business combination is presumed to be an alteration of equity interests in contemplation of the business combination and would preclude pooling accounting absent factual evidence to overcome the presumption.
- Any change in the original terms of outstanding stock options, warrants or other awards or grants would be considered a change in equity interests and, therefore, would preclude pooling accounting if made within two years prior to a combination, unless it can be demonstrated that the change was not made in contemplation of the business combination.

*Certain limited stock appreciation rights (LSARs) exist for approximately eight UNUM senior executives. These LSARs would vest immediately and entitle each executive to cash compensation if a change in control occurred. PWC noted UNUM amended these LSAR option agreements such that the UNUMProvident merger would not trigger*

<u>Pooling of Interests Criteria</u>	<u>Is Criteria Met?</u>	<u>Reference</u>
<i>immediate vesting and a cash payout. PWC noted that their national office recommended and approved this course of action so as to preserve UNUM's ability to account for the merger as a pooling. In addition, James F. Orr III was granted a significant level of options (400,000) in March 1998. PWC specifically reviewed this grant concluding it did not negatively impact the pooling criterion.</i>		
<p>6. Each combining enterprise may only reacquire shares of voting common stock for purposes other than business combinations, and no more than the normal volume of shares may be reacquired between initiation and consummation. In the absence of persuasive evidence to the contrary, it should be presumed that all acquisitions of treasury stock during the two years preceding the date a plan of combination is initiated were made in contemplation of effecting a business combination as a pooling of interests.</p> <ul style="list-style-type: none"> <li>➤ Treasury stock acquired for purposes other than business combinations includes shares for stock option and compensation plans and other recurring distributions provided a systematic pattern of reacquisitions is established at least two years before the plan of combination is initiated. A systematic plan of reacquisition may be established for less than two years if it coincides with the adoption of a new stock option or compensation plan. In determining the purpose of treasury stock acquisitions, the focus is on the intended and/or actual subsequent distribution of repurchased shares.</li> <li>➤ Acquisitions by other combining companies of voting common stock of the issuing company after the date the plan of combination is initiated are essentially the same as if the issuing company had reacquired its own stock.</li> </ul>	Yes	Covenant to meet this criteria contained in Agreement Article IV section 4.01

<u>Pooling of Interests Criteria</u>	<u>Is Criteria Met?</u>	<u>Reference</u>
<ul style="list-style-type: none"> <li>➤ The issuance of an equivalent number of shares prior to the date of consummation would generally provide evidence that the treasury shares were not acquired in contemplation of the combination. The "cure" could not be effected by merely retiring the treasury shares.</li> </ul>		
<p><i>PWC reviewed and analyzed the prior two years (using November 22, 1998 as the merger initiation date) of UNUM's share repurchases. While UNUM has aggressively repurchased shares in the past few years, PWC concluded that the number of tainted shares (shares repurchased and not reissued) did not violate this criterion.</i></p>		
<p>7. The ratio of the interest of an individual common stockholder to those of other common stockholders remains the same as a result of the exchange of stock to effect the combination.</p>	Yes	Agreement Article II and Form S-4 – all shares redeemed for identical shares
<p>8. The voting rights to which the common stock ownership interests in the resulting combined company are entitled are exercisable by the stockholders; the stockholders are neither deprived nor restricted in exercising those rights for a period.</p> <ul style="list-style-type: none"> <li>➤ This condition is not met if the shares of common stock issued to effect the combination are transferred to a voting trust.</li> <li>➤ No former stockholder of the company acquired can be prevented from exercising the voting rights of the shares of the issuing company that they are to receive.</li> </ul>	Yes	Agreement Article II and Form S-4 – common stock for common stock

<u>Pooling of Interests Criteria</u>		<u>Is Criteria Met?</u>	<u>Reference</u>
9.	<p>The combination is resolved at the date the plan is consummated and no provisions of the plan relating to the issue of securities or other consideration are pending.</p> <ul style="list-style-type: none"> <li>➤ This condition means that (1) the combined enterprise does not agree to contingently issue shares of stock or distribute other consideration at a later date to the former stockholders of a combining company or (2) the combined company does not issue or distribute to an escrow agent common stock or other consideration that is to be either transferred to common stockholders or returned to the company at the time the contingency is resolved.</li> <li>➤ An agreement may provide, however, that the number of shares of common stock issued to affect the combination may be revised for the later settlement of a contingency at a different amount than that recorded by a combining company.</li> </ul>	Yes	No contingencies noted in Agreement or Form S-4 or based on discussions with PWC
10.	The combined corporation does not agree directly or indirectly to retire or reacquire all or part of the common stock issued to effect the combination.	Yes	No such provisions noted by us or by PWC based on our discussions with them
11.	The combined company cannot enter into any arrangements to benefit former shareholders of a combining company, such as a guaranty of loans secured by stock issued in the combination, that in effect negates the exchange of equity securities.	Yes	No such provisions noted by us or by PWC based on our discussions with them
12.	The combined entity cannot plan to dispose of any significant portion of the assets of any combining entity within two years of the combination other than disposals in the ordinary course of business of the formerly separate company and to eliminate duplicate facilities or excess capacity.	Yes	No such significant disposals noted

<u>Pooling of Interests Criteria</u>	<u>Is Criteria Met?</u>	<u>Reference</u>
<ul style="list-style-type: none"> <li>&gt; In a situation where a previously planned disposal of a portion of the business or assets is not completed prior to the consummation of a pooling of interests transaction, strong evidence must exist to show that the planned disposal (if the disposal is significant) was unrelated to the pooling of interests transaction. Without such strong evidence, the disposal could be viewed as a violation; i.e., a disposal planned or intended at the date of the business combination.</li> </ul> <p>Other considerations may also disqualify a transaction if they violate the "uniting of interests" concept such as:</p> <ul style="list-style-type: none"> <li>&gt; Contingent purchase price</li> <li>&gt; Earn out provisions</li> <li>&gt; Resolution of litigation, tax audits, etc.</li> <li>&gt; Stock price guarantees</li> <li>&gt; Successful product launches</li> </ul>	Yes	None noted by us or by PWC based on our discussions with them

### *Current Events*

The Financial Accounting Standards Board (FASB) has undertaken a project to comprehensively reconsider the accounting standards for business combinations. This project was added to the Board's agenda mainly because of the complex set of interpretations that currently exist surrounding accounting for business combinations, and because the increasing complexity of international financial markets makes consistency in the area of accounting for business combinations very desirable. Pooling of interests is very rare in countries outside of the United States.

The current standards for business combinations include 2 APB opinions, 39 AICPA Interpretations of Opinion 16 and two AICPA Interpretations of Opinion 17, three FASB Interpretations and an FASB Technical Bulletin, and more than 50 issues related to business combinations and intangible assets considered by the Emerging Issues Task Force (EITF). Thirty-three of the 39 AICPA Interpretations of Opinion 16 address whether the pooling of interests method could be used in specific circumstances. In addition, the Securities and Exchange Commission has published four Accounting Series Releases and at least eight Staff Accounting Bulletins related to business combinations. Despite all those documents and the stringency of the 12 conditions in Opinion 16, new questions still arise in significant numbers. SEC representatives encouraged the Board to add the project to its agenda because of the continued need for interpretation on the part of the EITF and FASB



and because of the opportunity it presents for promoting the comparability of accounting standards internationally.

The FASB Issued a Special Report in June 1997 entitled *Issues Associated with the FASB Project on Business Combinations*. The purpose of the special report was to solicit input on the scope, conduct, and direction of the Business Combinations project. No tentative conclusions regarding revisions to the existing literature on Business Combinations have been reached, but the major issues relating to pooling of interests to be addressed by this project will likely include:

- Defining "business" and "business combination"
- Whether to retain the current system of two methods for accounting for business combinations
- If two methods are retained, when pooling of interests accounting will be used

### *Conclusion*

The combination will result in a single surviving entity, UNUMProvident Corporation, and will be effected through a 1 for 1 exchange of UNUM common stock for UNUMProvident common stock and a .73 to 1 exchange of Provident common stock for UNUMProvident common stock. The balance sheet and statement of operations of the surviving entity will combine all assets, liabilities, equity, income and expenses of the two formerly separate entities. Only those adjustments necessary in order to harmonize differing accounting methods and assumptions will be made. All periods presented will be restated as if the two entities had always been combined. Transaction costs, along with estimated costs to dispose of duplicate assets will be expensed in the period of the transaction.

Based on our discussions with UNUM management, UNUM's independent public accountant, PricewaterhouseCoopers, and the Bureau, as well as review of the Agreement and Plan of Merger dated as of November 22, 1998, and Form S-4, we are not aware of any factors that would disqualify the use of the pooling of interests method of accounting for the proposed merger. Additionally, based on our review of SEC comment letters to UNUM and related correspondence, it is apparent that the SEC reviewed the pooling of interest accounting treatment.

Although certain future transactions during the two year period after the merger is consummated could retroactively disqualify the use of the pooling of interests method, we are not aware that any such transactions are contemplated. We recommend that the Bureau consider requiring UNUMProvident to provide periodic reporting to the Bureau of its ongoing compliance with the pooling of interests criteria over the two year period subsequent to the consummation of the merger.

### 3. Tax Free Reorganization Analysis

#### Procedures

*Provide a definition of tax free corporate reorganizations as contemplated in Section 368(a) of the Internal Revenue Code of 1986, as amended. Based upon the facts and documentation provided, including legal opinions from UNUM and Provident's counsel, the contractor will provide their view of the taxability of the proposed transaction.*

#### **General Requirements for Tax Free Reorganizations**

We were requested by the State of Maine Bureau of Insurance to provide a definition of tax-free corporate reorganizations as contemplated in §368(a) of the Internal Revenue Code of 1986, as amended. The following is an outline of the general requirements necessary for corporate transactions to be accomplished tax-free.

1. **Business Purpose** - The transaction must be motivated by a business purpose other than avoidance of tax. Business purpose is not clearly defined in the Code or Regulations. If a transaction is an arm's-length transaction, the business purpose requirement ordinarily will be met. To satisfy the business purpose requirement, the transaction must proceed from a commercial motive.
2. **Continuity of Business** - The acquisition must be structured so that the business enterprise will be continued in its new corporate form. Continuity of business is defined in Regulation 1.368-2 as the acquiring corporation either continuing the acquired corporation's historic line of business or using a significant portion of its historic assets in a business. The regulations provide that, for a reorganization to meet the continuity of business enterprise requirement, the acquiring corporation must either continue at least one "significant" line of the acquired corporation's "historic business" or use in a business a "significant" portion of the acquired corporation's historic business assets, including stock and securities, goodwill, trademarks and other intangibles.
3. **Continuity of Ownership** - The owners of an acquired corporation must retain an interest in the reorganized corporation (acquirer) in order for the reorganization to be wholly or partly tax-free. (Treas. Reg. §1.368-1(b)). The intent is to ensure that the acquired corporation's shareholders maintain a substantial part of their equity participation in the acquired corporation following the acquisition.

Generally, to satisfy the continuity of interest requirement the target shareholders must:

- Exchange a substantial part by value of their stock for stock in the acquirer's stock - generally 50%. The 50% requirement will be met if acquired corporation's shareholders receive acquirer stock in an amount greater than or equal to 50% of the value of the acquired corporation. Depending upon specific circumstances, the 50% requirement may be reduced.

- Have an unrestricted right to maintain ownership of the acquirer stock for some period after the reorganization.
  - Retain ownership of the acquirer stock for some period (normally two years will suffice) or show that an early disposition of the stock was not pursuant to a plan or arrangement in place at the time of the reorganization.
4. **Specific Requirements of IRC §368(a)** - for reorganizations to be accomplished tax-free, one of the seven subsections of IRC §368(a) must be met. Based upon the information provided to us, the proposed transaction as currently structured, between UNUM Corporation, Inc. and Provident Companies, Inc. would be a stock-for-stock merger subject to the requirements of a 'B' Reorganization under IRC §368(a)(1)(B). A 'B' Reorganization is a nontaxable acquisition in which a company exchanges only its voting stock, or the voting stock of its parent, for the stock of another company sufficient to control (80%) the acquired company immediately after the transaction. The following are specific characteristics of 'B' Reorganizations.
- A. Cash paid by the acquiring corporation in lieu of the issuance of fractional shares will not violate the solely for stock rule provided the cash merely represents a mechanical rounding off of the fractions in the exchange and is not separately bargained for consideration. Rev. Rul. 66-365. However, this may generate taxable income to the stockholder.
  - B. A stock-for-stock exchange is the simplest, but most restrictive, of the tax-free acquisitions. The medium of exchange must be solely voting stock of the acquiring company. For the purposes of IRC §368(a)(1)(B), voting stock is stock which has the current right to vote in the election of corporate directors, whether the stock is common or preferred. Generally, if boot or consideration other than voting stock is used by the acquiring company, the exchange is fully taxable to the selling shareholders.
  - C. There are several items which are typically encountered in a stock-for-stock exchange and should be reviewed to avoid a possible IRS challenge that property other than voting stock was part of the overall consideration.
    - Payment by the acquiring company of expenses directly related to the acquisition is not treated as payment of consideration other than voting stock. However, the acquiring company may not transfer cash or other property to the acquired company so that it can pay the expenses directly related to the acquisition.
    - Continuing employment agreements are often a prime issue in acquisition negotiations. If the compensation in the employment contract is excessive and the contract is negotiated directly with the acquiring company, the IRS may challenge the tax-free status of the acquisition on the basis that the excess compensation represents consideration other than voting stock. Therefore, it is advisable for the employment contract

**EXHIBIT B**  
**UNUM Life Insurance Company of America**  
**Statutory Balance Sheet Variation Analysis**  
(In millions)

	Actual Results			Proforma After Effects of Merger							
	1996	1997	1998	1999	2000	2001					
Invested assets	\$7,377	-10.4%	\$6,612	3.6%	\$6,850	6.0%	\$7,259	9.4%	\$7,938	11.0%	\$8,812
Accounts receivable	194	12.4%	218	17.5%	256	13.7%	291	17.5%	342	17.0%	400
Other assets	69	40.1%	97	95.2%	190	7.5%	204	19.6%	244	19.3%	291
Total assets	<u>\$7,640</u>	<u>-9.3%</u>	<u>\$6,927</u>	<u>5.3%</u>	<u>\$7,296</u>	<u>6.3%</u>	<u>\$7,754</u>	<u>9.9%</u>	<u>\$8,524</u>	<u>11.5%</u>	<u>\$9,503</u>
Insurance reserves and liabilities	\$6,096	-8.9%	\$5,551	3.9%	\$5,768	5.7%	\$6,098	7.8%	\$6,576	9.6%	\$7,209
Other liabilities (excluding AVR)	467	-27.1%	341	2.2%	348	44.3%	502	19.7%	601	19.3%	717
Capital (including AVR)	<u>1,076</u>	<u>-3.8%</u>	<u>1,035</u>	<u>13.9%</u>	<u>1,179</u>	<u>-2.1%</u>	<u>1,154</u>	<u>16.7%</u>	<u>1,347</u>	<u>17.1%</u>	<u>1,577</u>
Total liabilities and equity	<u>\$7,640</u>	<u>-9.3%</u>	<u>\$6,927</u>	<u>5.3%</u>	<u>\$7,296</u>	<u>6.3%</u>	<u>\$7,754</u>	<u>9.9%</u>	<u>\$8,524</u>	<u>11.5%</u>	<u>\$9,503</u>

**EXHIBIT B**  
**Provident Life and Accident Insurance Company**  
**Statutory Balance Sheet Variation Analysis**  
(in millions)

	Actual Results			Proforma After Effects of Merger							
	1996	1997	1998	1999	2000	2001					
Invested assets	\$11,186	-6.7%	\$10,439	-6.3%	\$9,780	5.8%	\$10,351	5.5%	\$10,925	5.8%	\$11,563
Accounts receivable	316	5.0%	332	-8.5%	304	166.0%	807	-0.5%	803	-0.6%	799
Other assets	39	-8.6%	36	-32.8%	24	57.4%	38	0.0%	38	0.0%	38
Total assets	<u>\$11,541</u>	<u>-6.4%</u>	<u>\$10,806</u>	<u>-6.5%</u>	<u>\$10,108</u>	<u>10.8%</u>	<u>\$11,197</u>	<u>5.1%</u>	<u>\$11,766</u>	<u>5.4%</u>	<u>\$12,399</u>
Reserves	\$7,643	6.4%	\$8,134	4.5%	\$8,498	11.8%	\$9,497	5.2%	\$9,988	5.3%	\$10,518
Policyholders funds	2,842	-42.1%	1,646	-66.1%	559	-0.5%	556	-3.8%	535	-2.0%	524
Other liabilities	498	6.6%	531	0.6%	534	2.4%	547	0.0%	547	0.0%	547
Capital	559	-11.5%	495	4.7%	518	15.2%	597	16.9%	698	16.3%	812
Total liabilities and equity	<u>\$11,541</u>	<u>-6.4%</u>	<u>\$10,806</u>	<u>-6.5%</u>	<u>\$10,108</u>	<u>10.8%</u>	<u>\$11,197</u>	<u>5.1%</u>	<u>\$11,766</u>	<u>5.4%</u>	<u>\$12,399</u>

to be exclusively between the acquired corporation and the employee. Even in this case, there is a danger that the IRS will take the position that the employment contract has been used to give the employee-shareholder something in addition to voting stock, if the employment contract calls for excessive compensation. Pre-existing employment agreements normally should not cause a problem.

- For tax-free status, the acquiring company must exchange voting stock (common or preferred) for the stock of the acquired company. Exchanging cash or other property for other securities of the acquired company, even when its shareholders hold the securities, is not prohibited. Therefore, warrants and stock options may be acquired for cash without jeopardizing the tax-free status of the transaction. However, the security holder is taxed on any gain from the exchange.

#### D. Certain Advantages and Disadvantages of a Stock-for-Stock Transaction.

##### 1. Advantages

- The acquired company continues as a separate entity, eliminating such problems as the transfer of assets, assignment of rights and assumption of liabilities. This is particularly important when certain assets of the acquired company are not assignable.
- State and local tax problems on transfers of assets are avoided.
- Transfer costs for an asset acquisition are avoided.

##### 2. Disadvantages

- The medium of payment in a tax-free acquisition is limited to voting stock.
- Dissenting minority shareholder problems are more difficult to solve since the acquiring company cannot provide consideration for purchase of the minority interest. However, the acquired corporation may redeem up to 50% of its own stock prior to the reorganization without destroying the tax-free status of the reorganization (so long as the redemptions are not funded by the acquirer).
- The acquiring company must control at least 80% of the acquired company immediately after the transaction.
- Favorable tax attributes (NOL's, high-tax-basis assets or deficits in E&P) of the acquired company are not directly available for use by the acquiring company. NOL's and credit carryovers will be subject to Section 382 limitations. The acquiring company may use, within

limitations, current tax attributes of the acquired company (incurred after the acquisition) if it files a consolidated tax return that combines the parent and subsidiary.

- The acquiring company's tax basis in the stock of the acquired company equals the basis of the selling shareholders. This stock basis may be difficult to determine in the case of acquired public companies with widely held stock ownership. In these situations, it is prudent to obtain an independent report that uses statistical-sampling techniques for obtaining basis information.

#### *Taxability of UNUMProvident Merger*

We were requested by the State of Maine Bureau of Insurance to provide our view of the taxability of the proposed transaction between UNUM Corporation and Provident Companies, Inc. based upon the facts and documentation provided, including legal opinions. We have not received sufficient information to determine whether the proposed UNUMProvident merger would meet the aforementioned criteria for tax-free reorganizations under IRC §368(a). We have not received legal opinion letters from the Companies' counsel or a description of how the Companies intend to meet the requirements for a tax-free reorganization. Accordingly, we cannot express an opinion as to the taxability of this merger. However, the Companies have represented that it is their intention that the merger will be treated as a tax-free reorganization within the meaning of IRC Section §368(a). Based upon the information stated in the draft UNUM representation letter to Cravath, Swaine & Moore (Exhibit D to the Merger Agreement), and the draft Provident representation letter to Sullivan & Cromwell (Exhibit E to the Merger Agreement), it is evident that the Companies intend to take the necessary steps to accomplish the transaction tax-free.

We recommend that the Bureau obtain the legal opinions of the Companies' counsel upon their issuance.

#### 4. Capital Adequacy and RBC

##### Procedures

*Evaluate the adequacy of capital in support of continuing operations utilizing the standards outlined in the NAIC Risk Based Capital model as well as standards developed by Standard and Poor's Risk Based Capital model which is currently utilized by UNUM Corporation to maintain its "AA" rating.*

We performed actuarial calculations and analyses regarding Provident Life and UNUM America's reported Risk Based Capital (RBC) amounts as of December 31, 1998. Our calculations were consistent with the definitions of Risk Based Capital for Life and/or Health Insurers Model Act (the RBC Model Act) adopted by the National Association of Insurance Commissioners (NAIC) during December, 1992 and revised as of September, 1996.

RBC represents a dynamic approach to regulatory measurement of the capital adequacy of life and health insurers. The RBC formula calculates RBC as a mathematical combination of amounts for the following four categories of risk:

- Affiliate Risk (C-0) – the risk of assets' default for certain affiliated investments.
- Asset Risk (C-1) – the risk of asset default or adverse market fluctuation.
- Insurance Risk (C-2) – the risk of adverse mortality and morbidity experience.
- Interest Rate Risk (C-3) – the risk of loss due to changes in interest rate levels.
- Business Risk (C-4) – the risk associated with normal business and management.

##### *Provident Life's Risk Based Capital Analysis*

Listed below is a summary of our independent calculation of estimated RBC amounts for Provident Life:

	<u>Provident RBC</u> <u>December 31,</u> <u>1998</u> (\$ in millions)
Affiliate Risk (C-0)	\$ 2.8
Asset Risk (C-1)	126.8
Insurance Risk (C-2)	278.4
Interest Rate Risk (C-3)	17.5
Business Risk (C-4)	<u>14.2</u>
*Total	<u>\$330.1</u>



\*The total shown is not a sum of the component amounts, but a covariance adjusted aggregation of these items.

The RBC Model Act defines Adjusted Capital as an amount, based on statutory financial statements, which is to be compared with RBC. Provident Life's Adjusted Capital of approximately \$619.9 million as of December 31, 1998, based on Provident's 1998 statutory annual statement, consists of reported capital and surplus plus the Asset Valuation Reserve (AVR), voluntary investment reserves, subsidiary AVRs, and subsidiary voluntary investment reserves. Since Provident Life's Adjusted Capital of approximately \$619.9 million exceeds Company Action Level RBC of approximately \$330.1 million, no regulatory action is warranted based on the four levels of regulatory action indicated by the RBC Model Act. Further, it appears that Provident Life's Adjusted Capital exceeds, by a considerable margin, any levels of capital which would result in regulatory action or prompt regulatory concern. The resulting ratio of Adjusted Capital to Company Action Level RBC is approximately 188%, a value somewhat below industry averages (roughly 250% RBC for companies of size comparable to Provident Life). However, the company's RBC ratio is within a range (175% to 250%) considered "prudent" by the industry and by rating agencies, but near the lower end of such a range.

We compared our calculation of Provident Life's RBC to documentation of calculations prepared by the Company. The resulting ratio of Adjusting Capital to Company Action Level RBC based on Provident Life's calculation is 188%, which is the same ratio we calculated independently.

#### *UNUM America's NAIC Risk Based Capital Analysis*

Listed below is a summary of our independent calculation of estimated RBC amounts for UNUM America:

<u>UNUM America RBC</u> <u>December 31, 1998</u> (\$ in millions)	
Affiliate Risk (C-0)	\$ 0.4
Asset Risk (C-1)	109.1
Insurance Risk (C-2)	588.7
Interest Rate Risk (C-3)	13.5
Business Risk (C-4)	<u>22.5</u>
*Total	<u>\$624.2</u>

\*The total shown is not a sum of the component amounts, but a covariance adjusted aggregation of these items.

The RBC Model Act defines Adjusted Capital as an amount, based on statutory financial statements, which is to be compared with RBC. UNUM America's Adjusted Capital of approximately \$1,188.1 million as of December 31, 1998, based on UNUM America's 1998

statutory annual statement, consists of reported capital and surplus plus the Asset Valuation Reserve (AVR), voluntary investment reserves, subsidiary AVRs, and subsidiary voluntary investment reserves. Since UNUM America's Adjusted Capital of approximately \$1,188.1 million exceeds Company Action Level RBC of approximately \$624.2 million, no regulatory action is warranted based on the four levels of regulatory action indicated by the RBC Model Act. Further, it appears that UNUM America's Adjusted Capital exceeds, by a considerable margin, any levels of capital which would result in regulatory action or prompt regulatory concern. The resulting ratio of Adjusted Capital to Company Action Level RBC is approximately 190%, a value somewhat below industry averages (roughly 250% RBC for companies of size comparable to UNUM America). However, the company's RBC ratio is within a range (175% to 250%) considered "prudent" by the industry and by rating agencies, but near the lower end of such a range.

We compared our calculation of UNUM America's RBC to documentation of calculations prepared by the Company. The resulting ratio of Adjusting Capital to Company Action Level RBC based on UNUM America's calculation is 190%, which is the same ratio we calculated independently.

#### *Provident NAIC Risk Based Capital - Effect of Merger Expenses*

Based on the model used to independently calculate Provident's RBC amounts, we estimated the effect of certain merger expenses allocated to Provident (per regulatory filings). The estimated merger expenses, and the estimated effect on RBC, are as follows:

(\$ in Millions)				
Adjustment	Adjustment Amount	Revised RBC Amount	Revised Adjusted Capital	Revised RBC Ratio
Estimated Merger Expenses (After Tax)	\$ 25.6	\$330.1	\$594.3	180%

Therefore, it appears the combined effect of the merger expenses would result, on a pro-forma basis as of December 31, 1998, in a reduction in the RBC ratio from 188% to 180%, a level still within the range of levels considered "prudent" by the industry and rating agencies. However, there may be other items, not considered here (such as expected cost savings), which may mitigate the reduction in RBC ratios illustrated above.

#### *UNUM America's NAIC Risk Based Capital - Effect of Reserve Changes and Merger Expenses*

Based on the model used to independently calculate UNUM America's RBC amounts, we estimated the effect of certain reserve adjustments described earlier in this report, and we estimated the effect of certain merger expenses allocated to UNUM America (per

regulatory filings). The reserve adjustments and merger expenses, and the estimated effect on RBC, are as follows:

(\$ in Millions)				
Reserve Adjustment	Adjustment Amount	Revised RBC Amount	Revised Adjusted Capital	Revised RBC Ratio
Adjusted DLR Valuation Interest Rate*	\$ 55.0	\$ 626.9	\$ 1,133.1	181%
Estimated Merger Expenses (After Tax)	79.0	624.2	1,109.1	178%
Combined Effect of the Above Items	\$ 134.0	\$626.9	\$1,054.1	168%

\*See Section 5 of this report for our explanation of this adjustment.

Therefore, it appears the combined effect of the merger expenses and the increased DLR would result, on a pro-forma basis as of December 31, 1998, in a reduction in the RBC ratio from 190% to 168%, a level slightly below the range of levels considered "prudent" by the industry and rating agencies. However, there may be other items, not considered here (such as expected cost savings), which may mitigate the reduction in RBC ratios illustrated above.

#### *S&P Capital Adequacy Ratio*

We also performed actuarial calculations and analyses regarding Provident and UNUM America based on parameters utilized by Standard & Poor's, Inc. to determine S&P Required Capital (SRC) and S&P Capital Adequacy Ratio (SPCAR) amounts.

The SPCAR is comparable to RBC in that it represents a dynamic approach to regulatory measurement of the capital adequacy of life and health insurers. The SRC formula, as is the case with RBC, calculates SRC as a mathematical combination of amounts for the following four categories of risk:

- Asset Risk (C-1) -- the risk of asset default or adverse market fluctuation.
- Insurance Risk (C-2) -- the risk of adverse mortality and morbidity experience.
- Interest Rate Risk (C-3) -- the risk of loss due to changes in interest rate levels.
- Business Risk (C-4) -- the risk associated with normal business and management.

The SPCAR is a key component among many factors considered by S&P in determining a life insurer's claim-paying ability rating. However, in general, those insurers with higher SPCAR tend to receive corresponding higher S&P claims-paying ability ratings.

### *UNUM America's Standard & Poors Capital Adequacy Ratio (SPCAR) Analysis*

Listed below is a summary of our independent calculation of estimated S&P Required Capital (SRC) amounts and of the S&P Capital Adequacy Ratio (SPCAR) for UNUM America as of December 31, 1998:

	<u>UNUM America</u> <u>S&amp;P Required Capital</u> <u>December 31, 1998</u> (\$ in millions)
Insurance Risk (C-2)	\$648.6
Interest Rate Risk (C-3)	24.0
Business Risk (C-4)	<u>22.5</u>
*S&P Required Capital (SRC) = [(C-2)+(C-3)+(C-4)]	<u>\$ 695.1</u>
Adjusted Capital	\$1,188.1
Less Asset Risk (C-1)	<u>(170.4)</u>
=Total Adjusted Capital (TAC)	<u>\$1,017.7</u>
S&P Capital Adequacy Ratio (SPCAR) = (TAC/SBC)	<u>146%</u>

S&P defines Total Adjusted Capital (TAC) as an amount, based on statutory financial statements, which is to be compared with SRC. UNUM America's TAC of approximately \$1,107.7 million as of December 31, 1998, as based on UNUM America's 1998 statutory annual statement, consists of reported capital and surplus plus the Asset Valuation Reserve (AVR), voluntary investment reserves, subsidiary AVRs, subsidiary voluntary investment reserves, less the C-1 SRC component.

Our estimate of the SPCAR, the ratio of TAC to SRC, is approximately 146%, a value which, among other factors, support UNUM America's current S&P claims-paying ability rating of AA.

We compared our calculation of UNUM America's SRC calculations to documentation of calculations prepared by UNUM America. The resulting SPCAR based on UNUM America's calculation is approximately 150%, which is modestly higher than the ratio we calculated (146%). The difference is primarily the result of an apparent understatement by UNUM America of the C-3 component of SRC. It appears that UNUM America omitted the "annuity liabilities without adjustment" portion of the C-3 component, resulting in an apparent understatement of the C-3 component of SRC of approximately \$15.9 million.

### *Provident Life's Standard & Poors Capital Adequacy Ratio Analysis*

Listed below is a summary of our calculation of estimated SRC and SPCAR amounts for Provident as of December 31, 1998:

<u>Provident Life</u> <u>S&amp;P Required Capital</u> <u>December 31, 1998</u> (\$ in millions)	
Insurance Risk (C-2)	\$ 293.4
Interest Rate Risk (C-3)	41.3
Business Risk (C-4)	<u>13.8</u>
*S&P Required Capital (SRC)	
= [(C-2)+(C-3)+(C-4)]	<u>\$ 348.5</u>
Adjusted Capital	\$ 619.9
Less Asset Risk (C-1)	<u>(293.4)</u>
=Total Adjusted Capital (TAC)	<u>\$ 326.5</u>
S&P Capital Adequacy Ratio (SPCAR) = (TAC/SBC)	<u>94%</u>

Provident's TAC of approximately \$326.5 million as of December 31, 1998, as based on Provident's 1998 statutory annual statement, consists of reported capital and surplus plus the Asset Valuation Reserve (AVR), voluntary investment reserves, subsidiary AVRs, subsidiary voluntary investment reserves, less the C-1 SRC component.

Our estimate of Provident's SPCAR, the ratio of TAC to SRC, is approximately 94%, a value which, among other factors, support Provident's current S&P claims-paying ability rating of "A+".

Calculations of Provident's SRC amounts prepared by the company or any other third party were not available. Our estimate of Provident SRC amounts utilized SRC factors applied to UNUM America, with an approximate size adjustment to the bond factors to reflect reduced concentration risk in Provident's bond portfolio. Therefore, the SRC calculations for Provident should be regarded as rough estimates only, since the calculations have not been reconciled with company or third party calculations.

### *UNUM America's SPCAR - Effect of Reserve Changes and Merger Expenses*

Based on the model used to estimate UNUM America's SRC amounts, we estimated the effect of certain reserve adjustments described earlier in this report, and we estimated the effect of certain merger expenses allocated to UNUM America (per regulatory filings

submitted by UNUM). The reserve adjustments and merger expenses, and the estimated effect on the SPCAR, are as follows:

(\$ in Millions)				
Adjustment	Adjustment Amount	Revised SBC Amount	Revised TAC	Revised S&P Cap. Adequacy Ratio
Adjusted DLR Valuation Interest Rate	\$ 55.0	\$ 697.8	\$ 962.7	138%
Estimated Merger Expenses (After Tax)	79.0	695.1	938.8	135%
Combined Effect of the Above Items	\$ 134.0	\$697.8	\$883.8	127%

Therefore, it appears the combined effect of the merger expenses and the increased DLR would result, on a pro-forma basis as of December 31, 1998, in a reduction in the SPCAR from 146% to 127%. On a stand-alone basis, this may have a negative effect on UNUM America's AA S&P claims-paying ability rating. However, it appears that, upon closing of the proposed merger, S&P will consider the combined UNUM/Provident entity in assigning a claims-paying ability rating to all legal entities within the UNUM/Provident family of companies. Thus, in addition to the effect of merger expenses and reserve increases, UNUM America's S&P claims-paying ability rating will likely be affected negatively affected (relative to their current AA rating) by the UNUM/Provident merger, since Provident's capital adequacy (discussed below), as measured by S&P, is not as strong as UNUM America's. In addition, there may be other items, not considered here (such as expected cost savings), which may mitigate the reduction in S&P capital adequacy ratios illustrated above, and hence have a positive effect on UNUM America's ratings.

#### *Provident Life's SPCAR - Effect of Merger Expenses*

Based on the model used to calculate Provident's SRC amounts, we estimated the effect of certain merger expenses allocated to Provident (per regulatory filings submitted by UNUM). The estimated merger expenses, and the estimated effect on the SPCAR, are as follows:

(\$ in Millions)				
Adjustment	Adjustment Amount	Revised SRC Amount	Revised TAC	Revised S&P Cap Adequacy Ratio
Estimated Merger Expenses (After Tax)	\$ 25.6	\$348.5	\$301.0	86%

Therefore, it appears the combined effect of the merger expenses would result, on a pro-forma basis as of December 31, 1998, in a reduction in the SPCAR from 94% to 86%. On a stand-alone basis, this might have a negative effect on Provident's A+ S&P claims-paying

ability rating. However, it appears that, upon closing of the proposed merger, S&P will consider the combined UNUM/Provident entity in assigning a rating to all legal entities within the UNUM/Provident family of companies. Thus, in addition to the effect of merger expenses and reserve increases, Provident's S&P claims-paying ability rating will likely be affected positively (relative to their current A+ rating) by the UNUM/Provident merger, since UNUM America's capital adequacy (discussed above), as measured by S&P, is stronger than Provident's. In addition, there may be other items, not considered here (such as expected cost savings), which may mitigate the reduction in S&P capital adequacy ratios illustrated above, and hence have a positive effect on Provident's ratings.

### *Conclusions*

Based on our limited-scope review, we conclude the following regarding UNUM America and Provident Life's RBC and SPCAR amounts:

- Both UNUM America and Provident Life's RBC amounts and resulting RBC ratios as of December 31, 1998, as reported by the Companies, appear to be reasonably stated.
- UNUM America and Provident Life's RBC ratios (Adjusted Surplus divided by Company Action Level RBC) are estimated, as of December 31, 1998, at 190% and 188%, respectively, which are levels below industry averages (of roughly 250%) for comparably-sized companies, but within the range of RBC ratios (175% to 250%) considered "prudent" in the life insurance industry and with rating agencies.
- For UNUM America, we estimate that the combined effect of estimated merger expenses of approximately \$79.0 million and of an anticipated increase in disabled life reserves of approximately \$55 million would reduce UNUM America's RBC ratio as of December 31, 1998 from approximately 190% to approximately 168%, a level slightly below the range of levels considered "prudent" by the industry and by rating agencies.
- For Provident, we estimate that the combined effect of estimated merger expenses of approximately \$25.6 million would reduce Provident's RBC ratio as of December 31, 1998 from approximately 188% to approximately 180%, a level still within the range of levels considered "prudent" by the industry and by rating agencies.
- UNUM America's SPCAR amounts, as prepared by the Company, appear to modestly overstate the SPCAR. UNUM America calculated a SPCAR ratio of approximately 150%, whereas our recalculation of the SPCAR was approximately 146%. The overstatement results from an apparent omission of a certain item in the C-3 component of the S&P Required Capital (SRC) amount.
- For UNUM, it appears that the combined effect of the merger expenses and the increased DLR would result, on a pro forma basis as of December 31, 1998, in a reduction in the SPCAR from 146% to 127%. On a standalone basis, this may have a negative effect on its "AA" S&P claims-paying ability rating. However, in addition

to the effect of merger expenses and reserve increases, UNUM America's S&P claims-paying ability rating will likely be affected negatively (relative to its current "AA" rating) by the UNUMProvident merger, since Provident's capital adequacy (discussed below), as measured by S&P, is not as strong as UNUM America's.

- For Provident Life, it appears that the combined effect of the merger expenses would result, on a pro forma basis as of December 31, 1998, in a reduction in the SPCAR from 94% to 86%. On a standalone basis, this might have a negative effect on its "A+" S&P claims-paying ability rating. However, in addition to the effect of merger expenses and reserve increases, Provident Life's S&P claims-paying ability rating will likely be affected positively (relative to its current "A+" rating) by the UNUMProvident merger, since UNUM America's capital adequacy (discussed above), as measured by S&P, is stronger than Provident's.



## 5. Reserving Practices

### Procedures

*Discuss the underlying reserving assumptions and methodology with the Companies' actuaries. Based on these discussions, compare the Companies reserving methodologies and the development of the assumptions with your firm's knowledge of the industry in which the Companies compete. In areas where the Companies established miscellaneous reserve estimates, such as a claim integration reserve, obtain support from the Companies to satisfy your firm that these miscellaneous reserve estimates appear reasonable. In all instances above, provide a written synopsis of the findings in your final report.*

### UNUM Life Insurance Company of America (UNUM America)

As of December 31, 1998, UNUM America held the following reserves on a statutory basis, net of reinsurance ceded:

<u>Product</u>	<u>Reserve (\$ in millions)</u>	<u>Percent of Total</u>
Group Long-Term Disability (LTD)	\$3,961	70%
Individual Disability Insurance	866	15%
All Other	820	15%
Total	<u>\$5,647</u>	<u>100%</u>

The methods and assumptions used to calculate reserves for these products are discussed below:

### Group LTD Reserves

Statutory reserves associated with UNUM America's Group LTD product as of December 31, 1998 were approximately:

	<u>(\$ in millions)</u>
Incurred but not reported (IBNR) reserve	\$ 389
Disabled Life Reserve (DLR)	\$3,524
Reopen Reserve	<u>48</u>
	<u>\$3,961</u>

The amounts above include two adjustments representing temporary departures from UNUM America's standard methods and assumptions to reflect temporary changes in the nature of the underlying liabilities. These adjustments are as follows:

- LTD Inventory Buildup Reserve Adjustment (decrease of approximately \$193 million), and

- Claim Operations Integration Reserve (increase of approximately \$59.4 million).

Also, as of the proposed date of the merger, UNUM America intends to adjust the interest rate used to calculate its GAAP DLR reserve. UNUM America estimates this adjustment to increase GAAP reserves as of June 30, 1999 will be approximately \$230 million. Since certain portions of the statutory reserves are based on GAAP assumptions, this change in the GAAP reserve interest rate is projected to cause an increase of approximately \$55 million in UNUM America's statutory reserves as of June 30, 1999. A summary of the effect of the three adjustments to statutory reserves is as follows (while the valuation dates of the adjustments differ, the sum of the adjustments still provide perspective with respect to the total effect of the adjustments):

<u>Adjustment</u>	<u>Valuation Date</u>	<u>Statutory Impact</u> <u>(\$ millions)</u>
LTD Inventory Buildup	December 31, 1998	(\$193)
Claim Operations Integration Reserve	December 31, 1998	59
GAAP Interest Rate Change	June 30, 1999	55
Total Adjustment		<u>(\$79)</u>

Each of the reserves and adjustments is described in the sections which follow:

#### IBNR Reserve

UNUM America's IBNR reserve for LTD is set to equal to the sum of the Waiting Period (WP) reserve and the "Reopen Reserve."

#### Waiting Period Reserve

The WP reserve is established to reflect the liability for insured lives which have sustained injuries or contracted illnesses which may qualify them to receive benefits, but have not yet completed the waiting period associated with the insurance contract. Some of these potential claimants are known to UNUM America since they have filed claims in anticipation of completing the WP, and some are not known yet.

UNUM America determines the WP reserve by multiplying "lag factors" times the quarterly premium for the most recently completed eight quarters, times 1.04. UNUM America develops the lag factors based on "lag studies" in which UNUM America relates the premium for a quarter, the claims incurred during that quarter, and the number of quarters of delay between the incurral date and the date the claim was reported to UNUM America. The factor of 1.04 is used to include a measure of conservatism. The GAAP WP reserve is set equal to the statutory reserve.

UNUM America's method of determining the WP reserve appears to be more sophisticated than is typical. Many companies calculate a WP reserve as a factor

(equal to the expected loss ratio for the period up to a value of 1.00) times the WP premium. To provide perspective regarding UNUM America's method, we compared UNUM America's WP reserve as of December 31, 1998 to the WP premium. The ratio of the reserve to the WP premium was approximately 72%. Since UNUM America's loss ratio for its LTD business is typically between approximately 65% and 70%, UNUM America's results appear to be comparable to the result obtained by using the typically used, albeit simpler, method.

### Reopen Reserve

The reopen reserve is established to reflect the liability for recently closed LTD claims that may "reopen." Reasons that an LTD claim may reopen include reinjury, relapse, and receiving additional information which justify the resumption of claim payments. For claims "resolved" (that is, closed) during the preceding 12 quarters, the reopen reserve is determined by multiplying a factor times the reserves released in a given quarter due to claims resolutions. The factor varies based on the length of time since the claim was resolved. The factor for claims resolved more than 12 quarters ago is set equal to zero. The factors are determined based on UNUM America's experience. LTD insurers do not typically hold a specific reopen reserve. However, the method used to develop this reserve appears reasonable, and appears to add a measure of conservatism to the reserves. The reopen reserve for GAAP purposes is the same as the statutory reserve.

### Disabled Life Reserve

The DLR is calculated as the present value of future benefits for each insured life which has qualified as being disabled and has completed the waiting period for the contract. Assumptions and policy parameters used to calculate this reserve include:

- Mortality
- Recovery
- Probability of approval for Social Security benefits
- Amount of LTD benefit offset relating to Social Security benefits, including future increases thereof
- Cost of living increases in the LTD benefit amount
- Duration of the WP and the LTD benefit (such as 10 years, to age 65, or for life)
- Cause of disability
- Definition of disability (that is, inability to perform the insured's own occupation ("own occ") or inability to perform any occupation for which the insured is reasonably suited ("any occ"))

UNUM America develops its assumptions by periodically analyzing its LTD experience. UNUM America typically performs experience studies every five years. Based on these studies, UNUM America calculates expected mortality and

recovery rates based on various factors, including age, cause of disability, and time since disability. Based on discussions with UNUM America representatives, when the most recent set of assumptions was developed, the aggregate difference between reserves calculated under the current assumptions and those calculated under the prior assumptions was minimal. In addition, UNUM America compared reserves calculated using an alternative calculation of such reserves based on standard industry tables. Reserves using UNUM America's own assumptions are between 85% and 100% of the alternative reserves based on standard industry tables. (Reserves for recently disabled people tend to be approximately 85% of reserves using standard industry tables, and reserves for people disabled for longer periods of time tend to approach 100% of reserves using standard industry tables). Therefore, it appears that UNUM America's LTD experience is a reasonable source of information upon which to develop assumptions.

UNUM America is permitted to use its own experience to calculate the statutory DLR for claims in the first five years since disability. For claims beyond this period, standard industry tables are used. UNUM America calculates the GAAP DLR based on the assumptions developed from its experience as described above. The statutory DLR is set equal to the 110% of the GAAP DLR.

#### LTD Inventory Buildup Reserve Adjustment

During the fourth quarter of 1997, UNUM America instituted a change in claim resolution procedures. Claim resolution procedures are guidelines used to determine which claims should be approved, denied, or investigated and recommended for closure. As a result, claim resolutions decreased significantly in the fourth quarter of 1997 and did not return to previous levels until the third quarter of 1998, as seen in Exhibit I. As a result of this "backlog," UNUM America experienced an increase in the number of claims reaching the elimination period and generated an increase in the DLR. UNUM America estimates that approximately 5,000 claims reached the elimination period which, under normal circumstances, would have been resolved before completing the elimination period. The buildup of these 5,000 claims is represented by the first area between the solid and dashed lines on Exhibit I. To eliminate the backlog, UNUM America has implemented several action steps including accelerated hiring of 113 claim processing positions, and added capacity through a Saturday work program. The expected resolution of the claims is represented by the second area between the solid and dashed lines on Exhibit I.

Since the resolution rate for these 5,000 claims is expected to be faster than claims under normal circumstances, UNUM America adjusted its GAAP and statutory DLR for these claims. The adjustment was calculated by first determining the expected number of backlogged claims at the end of each quarter from September 30, 1998 through June 30, 2000. These amounts were estimated to be as follows:

<u>Date</u>	<u>Estimated Number of Backlogged Claims</u>
September 30, 1998	5,000
December 31, 1998	4,600
March 31, 1999	3,800
June 30, 1999	2,800
September 30, 1999	1,600
December 31, 1999	600
March 31, 2000	300
June 30, 2000	0

The inventory buildup reserve adjustment as of a given valuation date was then calculated as follows:

<u>Estimated number of backlogged claims as of valuation date</u>	<u>x</u>	<u>(</u>	<u>Average DLR per claim</u>	<u>-</u>	<u>Present value of estimated payments for backlogged claims from valuation date to June 30, 2000</u>	<u>)</u>
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The above calculated amount was then deducted from the DLR. Since the number of backlogged claims is expected to be zero on June 30, 2000, this adjustment will be zero as of this date. According to UNUM America representatives, this reserve reduction adjustment will not be extended beyond this date. UNUM America's independent auditors, PricewaterhouseCoopers LLP, have reviewed this adjustment and monitors the adjustment periodically. The Bureau was informed of this adjustment to UNUM America's reserves, and has permitted the adjustment.

#### Claim Operations Integration Reserve

The claim operations integration reserve is a positive adjustment to both the statutory and GAAP DLR reserves established by UNUM America and accounts for the expected decrease in efficiency of claim processing during the "merger transition period" (the period of time leading up to and soon after the merger of UNUM America and Provident). UNUM America expects that the resolution rate of claims will be lower during this period of time and warrants an additional reserve to reflect the increased liability. A decrease in the resolution rate of claims tends to increase reserves since claims payments continue longer than originally expected. This change in the claims resolution rate is in addition to the change described in the Inventory Buildup Reserve section above.

In order to calculate the claims operations integration reserve, UNUM America calculated the DLR using revised claim resolution assumptions. The claims operations integration reserve was set equal to the difference between the DLR calculated using the revised claim resolution assumptions and the DLR

calculated using the unadjusted claim resolution assumptions. Claim processing efficiency is expected to return to normal levels by December 31, 1999. UNUM America has established the following values for use in calculating the claims operations integration reserve and estimate the reserve as follows :

<u>Date of Reserve</u>	<u>Ratio*</u>	<u>Claim Operations Integration Reserve</u>
December 31, 1998	90%	\$59.4 million
March 31, 1999	90%	45.3 million
June 30, 1999	81%	31.2 million
September 30, 1999	85%	13.2 million
December 31, 1999	100%	0.0 million

\* Ratio of adjusted claim resolution rate assumption for claims operations integration reserve to unadjusted assumption.

Actual experience shows that during the first quarter of 1999, the ratio of actual claim resolutions to expected claim resolutions under normal circumstances was approximately 88% compared to the estimated value of 90%. Therefore, the assumptions for the claims operations integration reserve as of December 31, 1998 and March 31, 1999 appear reasonable. We recommend that UNUM America monitor this ratio until the end of 2000, make adjustments as appropriate, and report any differences and adjustments to the State of Maine.

#### Change in Interest Rate Assumption

Provident allocates sufficient assets to each line of business to appropriately "match" the liabilities associated with the business. These assets are then managed in a manner reflecting that line of business. Assets associated with Provident's surplus are managed in aggregate. In contrast, UNUM America allocates a portion of its surplus to each line of business and allows the asset management team for each line of business to invest that surplus in accordance with its investment management objectives. The interest rate used to calculate the GAAP DLR for LTD is determined based on the interest rate earned on the LTD portfolio. (Interest rates for statutory reserves are based on prescribed interest rates.)

As of the date of the merger, it is expected that the investment function of UNUMProvident (the combined entity) will be performed by Provident's personnel and according to Provident's current investment strategies. Therefore, as of the date of the merger, UNUM America intends to move a portion of the LTD portfolio to a corporate surplus account. The assets remaining in the LTD portfolio will be chosen to "match" the liabilities of the LTD product and Provident's investment strategy for the product.

In order to estimate the effect on the LTD portfolio interest rate, UNUM America projected the current LTD portfolio and liabilities to the date of the proposed merger. Based on the results of these projections, UNUM America then

identified a subset of the assets which would match the product's projected liabilities and the changed investment strategy. All remaining assets were allocated to the corporate surplus account. As a result of the above described changes, the investment rate return and the impact on reserves for the LTD portfolio is expected to be as follows:

Impact of moving of assets to the surplus account	0.83%
Impact of changed investment strategy:	
Duration lengthening	0.02%
Investment inventory	0.05%
Default risk and other investment characteristics	<u>0.18%</u>
Total Interest Rate Decrease	<u>1.08%</u>
Total GAAP Reserve Increase (\$ millions)	<u>\$160</u>

### *Individual Disability Income*

UNUM America sells individual disability income (IDI) products which replace a portion of a person's income if that person becomes disabled. UNUM America holds three separate reserves associated with its IDI products. The amounts of these reserves as of December 31, 1998 on a statutory basis were:

(\$ in millions)

Active Life Reserve	\$ 49
Claim Reserve	\$799
IBNR Reserve	<u>\$ 18</u>
	<u>\$866</u>

The active life reserve is calculated using a two year preliminary term method. Morbidity is based on UNUM America's morbidity experience and interest is based on specified statutory maximum interest rates. The resulting reserves are tested against statutory minimum reserves which are calculated assuming morbidity follows either the 85 CIDA or 64 CDT tables, depending on the year of issue of the policy. If the statutory minimum reserve is larger than the reserves based on UNUM America's morbidity experience, the statutory minimum reserve is recorded.

Claim reserves are calculated as the present value of future benefits, also based on UNUM America's morbidity experience and specified statutory maximum interest rates. As with the active life reserve, the claim reserve is tested against the statutory minimum reserve using the 85 CIDA or 64 CDT table as appropriate, and the minimum reserve is recorded if larger.

IBNR reserves as of a given valuation date are based on premiums for the most recently completed 24 months times various factors. The factors are developed based on "claim run-off studies" in which UNUM America relates the premium for a month, the claims incurred during that month, and the number of months of delay between the incurral date and the date the claim was reported to UNUM America.

### Other Lines of Business

Other lines of business at UNUM America include:

- > Individual life insurance
- > Group life insurance
- > Individual annuities
- > Group annuities
- > Group health insurance

Reserves for each of these lines of business represent less than 10% of UNUM America's total reserves. Based on discussions with UNUM America representatives, reserves for these lines of business appear to be based on methods and assumptions which are commonly used in the insurance industry.

### *Provident Life and Accident Insurance Company (Provident Life)*

As of December 31, 1998, Provident Life held the following reserves on a statutory basis, net of reinsurance ceded:

<u>Product</u>	<u>Reserve</u> <u>(\$ in millions)</u>	<u>Percent</u> <u>of Total</u>
Individual Disability Income	\$3,502	38%
Individual Life	3,254	36%
Single Premium Annuity	1,052	12%
All Other	<u>1,315</u>	<u>14%</u>
Total	<u>\$9,123</u>	<u>100%</u>

The methods and assumptions used to calculate reserves for these products are discussed below:

### Individual Disability Income

Provident Life sells non-cancelable individual disability income (IDI) products which replace a portion of a person's income if that person becomes disabled. For policies sold since 1993, the definition of "disabled" typically refers to the insured's own occupation for an initial period since disability (often 2 years), and any occupation for which the insured is reasonably suited after that initial period. Previously, Provident Life sold IDI policies which defined disability as the inability to perform the insured's own occupation with no time limits on that definition. Provident Life holds three separate reserves associated with its IDI products. These reserves are:

- > Active Life Reserve
- > Claim Reserve
- > IBNR Reserve



The active life reserve is calculated using a two year preliminary term method. Morbidity is assumed to follow either the 85 CIDA or 64 CDT tables, depending on the year of issue of the policy. Interest rates used are the specified statutory maximum interest rates.

Claim reserves are calculated as the present value of future benefits, also using either the 85 CIDA or 64 CDT tables and specified statutory maximum interest rates. As a measure of conservatism, claim reserves for claims which have been open one year or less are increased by 10%.

IBNR reserves as of a given valuation date are based on premiums for the most recently completed 24 months times various factors. The factors are developed based on "claim run-off studies" in which Provident Life relates the premium for a month, the claims incurred during that month, and the number of months of delay between the incurral date and the date the claim was reported to Provident Life.

On a GAAP basis, Provident Life calculates reserves using comparable methods, however, morbidity is assumed to follow the 94A morbidity table, the table used to develop the pricing of the product, plus a 10% margin for conservatism. The current interest assumption is approximately 8.0%, which is developed based on the current portfolio interest rate of return of approximately 8.2%.

On a GAAP basis, Provident Life holds an additional "loss recognition reserve" relating to non-cancelable, "own occ" IDI policies issued in 1993 and prior. These policies have experienced significant antiselection, particularly for those policies sold to physicians. The reserve adjustment as of September 30, 1993 (the date the loss recognition reserve was established) was approximately \$321.8 million. As of December 31, 1998, the adjustment was approximately \$174.8 million. As a result of their experience with these policies, Provident Life instituted several changes in order to reduce the risk of encountering comparable problems in the future. These changes included:

- Development of the new "any occ" policies issued since 1994
- Strengthening financial underwriting standards
- Increasing cash flow "matching"
- Increasing the diversification of sales

Provident Life periodically analyzes statutory reserves relating to the non-cancelable own occ IDI policies to determine whether an additional statutory reserve is appropriate. According to Provident Life's representatives, no adjustment has been warranted due to the inherent conservatism of the statutory reserves.

As of December 31, 1998, Provident Life was holding a claims disruption reserve on a GAAP basis of approximately \$93.6 million. This is an extra reserve comparable to the claim operations integration reserve held by UNUM America, and was calculated using methods comparable to the methods used by UNUM America.

Based on its experience during the recent acquisition of Paul Revere Life Insurance Company, Provident has established the following values for use in calculating the claims operations integration reserve and estimate the reserve as follows:

<u>Date of Reserve</u>	<u>Ratio*</u>	<u>Claims Operations Integration Reserve</u>
December 31, 1998	90%	\$93.6 million
March 31, 1999	90%	71.5 million
June 30, 1999	85%	49.4 million
September 30, 1999	90%	19.8 million
December 31, 1999	100%	0.0 million

\* Ratio of adjusted claim resolution rate assumption for claims operations integration reserve to unadjusted assumption

#### Individual Life Insurance

Statutory reserves for individual life insurance are calculated using the Commissioner's Reserve Valuation Method (CRVM) and specified interest rates. Universal Life (UL) reserves are calculated in accordance with the Model UL Law. On a GAAP basis, UL reserves are set equal to the account value. In general, other life policies are valued based on net level premium reserving methods using the interest rate earned by the portfolio supporting the life insurance liabilities. Mortality is assumed to be equal to the mortality used to develop the pricing of the policies, plus a margin of 10%.

#### Single Premium Annuity

Provident sold single premium annuities to pension plans which were being terminated. A single premium annuity was purchased by the pension plan to provide specified annuity benefits to the beneficiaries of the plan. Provident no longer sells single premium annuities. Statutory reserves for single premium annuities are set equal to the present value of future benefits with mortality assumed to follow the 83GAM mortality table and prescribed interest rates. GAAP reserves are calculated using the same method and assumptions, except that interest is assumed to be equal to the interest rate used to develop the product pricing, less a margin for conservatism.

#### Other Lines of Business

Other lines of business at Provident Life include:

- Group long term disability
- Group life
- Guaranteed investment contracts

Statutory reserves for each of these lines of business represent less than 10% of Provident's total reserves. Based on discussions with Provident Life representatives, reserves for these lines of business appear to be based on methods and assumptions which are commonly used in the insurance industry.

### *Conclusion*

Based on our discussions with both UNUM America and Provident Life representatives, the methods used to calculate GAAP and statutory reserves for the significant lines of business of each Company appear to be comparable to methods typically used in the insurance industry for those lines of business. In addition, the process used to choose the underlying assumptions, as described by UNUM America and Provident Life representatives, also appears to be comparable to processes typically used in the insurance industry for those lines of business. However, due to the limited scope of our analysis, we cannot conclude regarding the reasonableness and appropriateness of the assumptions, or the reasonableness of the resulting UNUM America and Provident Life reserve values as of December 31, 1998.

We recommend that the Bureau consider:

- Performing a more in-depth analysis to determine whether the methods and assumptions used by both companies to calculate their respective GAAP and statutory reserves appear reasonable and appropriate and to determine whether the resulting values as of December 31, 1998 appear reasonably stated
- Monitoring the following reserve adjustments on a quarterly basis:
  - UNUM America's LTD inventory buildup reserve adjustment
  - UNUM America's claim operations integration reserve
  - Provident Life's claims disruption reserve
- Performing a detailed analysis of UNUM America's change in GAAP DLR interest rate assumption at the time that UNUM America determines the actual effect of the change in investment strategy.

## 6. Dividend Policies

### Procedures

*Evaluate the dividend policies utilized by UNUM and Provident both pre and post merger and determine if these policies are reflected in the business plan.*

### Background

UNUM America management has stated that it is their intention to maintain risk-based capital in UNUM America at the appropriate level to maintain its current ratings. After the merger with Provident Companies, Inc., it is contemplated that the insurance affiliates of UNUMProvident Corporation will receive a group rating and that management will establish and maintain a level of risk-based capital that will support the ratings that are appropriate for the new company group.

There are no plans for UNUM America to pay any extraordinary dividends for the next year. Extraordinary dividends may be paid in the event of a sale of assets, however, the Company will be required to provide the Superintendent of Insurance prior notice of such an event.

As stated in the Companies Form S-4 filing with the SEC, the ability of the merged company, UNUMProvident, to continue to pay dividends in the future without regulatory approval will be dependent upon the level of earnings of its insurance subsidiaries, which include UNUM America and Provident Life. In addition to regulatory restrictions, the amount of dividends that can be paid by insurance subsidiaries will depend on additional factors, such as risk-based capital ratios, funding growth objectives at an affiliate level and maintaining appropriate capital adequacy ratios to support the ratings desired by the Companies. UNUM America management has stated that ordinary dividends may be paid during this period, but have stated that they will maintain a minimum capitalization of 300% of the NAIC authorized control level risk-based capital.

### Dividends from the Insurance Companies to their Parents

We performed a review of the historical dividend policies of UNUM America and Provident Life by reviewing the filed statutory annual statements for both Companies for the three years prior to the anticipated merger (1996, 1997 and 1998). Both Companies show a consistent pattern of paying dividends to their respective parents as indicated in the following tables:

UNUM Life Insurance Company of America  
Dividends to Parent  
(000's)

	<u>1996</u>	<u>1997</u>	<u>1998</u>
Dividends	\$ 179,301	\$180,000	\$28,500*
Net income	116,404	177,853	22,313
Dividends as a % of income	154.0%	101.2%	127.7%
Dividends as a % of surplus (after dividends added back)	16.6%	16.0%	2.6%

\* There was a contribution to surplus of \$160,000,000 in 1998.

All UNUM Insurance Companies  
Dividends to Parent  
(000's)

	<u>1996</u>	<u>1997</u>	<u>1998</u>
Dividends	\$ 240,301	\$244,000	\$51,500
Net income	169,968	222,122	65,980
Dividends as a % of income	141.1%	109.8%	78.1%
Dividends as a % of surplus (after dividends added back)	17.4%	17.4%	3.7%

Over the past three years, UNUM America has paid dividends to its parent. It is reasonable to assume that they will continue to pay dividends during the next three years. The same statement can be made for Provident Life.

Provident Life and Accident Insurance Company  
Dividends to Parent  
(000's)

	<u>1996</u>	<u>1997</u>	<u>1998</u>
Dividends	\$ 42,265	\$ 94,905	\$66,170
Net income	102,246	36,479	16,173
Dividends as a % of income	41.3%	260.2%	409.1%
Dividends as a % of surplus (after dividends added back)	6.4%	17.9%	12.4%

All Provident Insurance Companies  
Dividends to Parent  
(000's)

	<u>1996</u>	<u>1997</u>	<u>1998</u>
Dividends	\$ 60,601	\$111,905	\$136,889
Net income	(3,986)	77,427	199,448
Dividends as a % of income	N/A	144.5%	68.6%
Dividends as a % of surplus (after dividends added back)	4.8%	7.6%	8.3%

*Dividends to Shareholders of Provident Companies, Inc. and UNUM Corporation*

We reviewed the dividend policies of the holding companies for the same time period noted above. Both Companies have maintained comparable and consistent payout patterns. The outstanding shares of common stock are held primarily by 13-F institutions, (e.g., pension plans, mutual funds, trusts, etc.). Since the majority of shares of both companies are owned by 13-F institutions, we believe that it is likely that the dividend payouts will remain consistent.

The following tables present the respective dividend trends of each Company:

UNUM America

	<u>1998</u>	<u>1997</u>	<u>1996</u>
Net income per diluted common share	\$2.57	\$2.59	\$1.61
Net income per basic common share	\$2.63	\$2.65	\$1.63
Dividends paid per share	\$585	\$565	\$545
Dividends paid as a percent of earnings	22.2%	21.3%	33.4%

As of December 31, 1998

	<u>UNUM</u>	<u>Industry</u>	<u>Sector</u>	<u>S&amp;P 500</u>
Dividend yield	1.26	0.71	1.66	1.43
Dividend yield - 5 year average	2.00	1.20	2.06	1.85
Dividend - 5 year growth rate	8.87	3.52	15.16	9.76
Payout ratio (trailing 12 months)	22.26	12.88	26.64	29.61

Provident Life

	<u>1998</u>	<u>1997</u>	<u>1996</u>
Net income per diluted common share	\$1.82	\$1.84	\$1.44
Net income per basic common share	\$1.87	\$1.88	\$1.46
Dividends paid per share	\$ .400	\$ .380	\$ .360
Dividends paid as a percent of earnings	21.4%	20.2%	24.7%

As of December 31, 1998

	<u>Provident</u>	<u>Industry</u>	<u>Sector</u>	<u>S&amp;P 500</u>
Dividend yield	1.17	0.71	1.66	1.43
Dividend yield - 5 year average	1.60	1.20	2.06	1.85
Dividend - 5 year growth rate	-5.11	3.52	15.16	9.76
Payout ratio (trailing 12 months)	21.43	12.88	26.64	29.61

The data presented to the Bureau is not the proposed merged GAAP entity because it does not include data from the other insurance and non-insurance subsidiaries. In 1998, capital and surplus from the other domestic insurers was as follows for each Company:

UNUM Corporation  
Domestic U.S. Insurers Capital and Surplus  
December 31, 1998

UNUM Life Insurance Company of America	\$1,086,997	81.6%
First UNUM America Insurance Company	111,531	8.4%
Colonial Life and Accident Insurance Company	131,121	9.8%
Continental National Life Insurance Company	1,380	.1%
Continental International Life Insurance Company	1,360	.1%
Total Domestic Insurers	<u>\$1,332,389</u>	<u>100.0%</u>

Provident Companies, Inc.  
Domestic U.S. Insurers Capital and Surplus  
December 31, 1998

Provident Life and Accident Insurance Company	\$ 518,236	35.7%
Provident Life and Casualty Insurance Company	77,736	5.4%
Provident National Insurance Company	56,690	3.9%
Paul Revere Life Insurance Company	599,525	41.3%
Paul Revere Protective Life Ins Co	104,651	7.2%
Paul Revere Variable Annuity Ins Co	94,789	6.5%
Total Domestic Insurers	<u>\$1,451,627</u>	<u>100.0%</u>

### *Conclusion*

Based on our review of the Business Plans of both UNUM America and Provident Life, both companies did not include a dividend strategy or projection of the dividends to be paid. We recommend that the Bureau require the submission of a revised Business Plan that reflects the more likely scenario of dividends being paid, along with the submission of a dividend plan.



## 7. Market Conduct Analysis

### Procedures

*Review the filing and address issues relating to market conduct activity and claims practices of Provident.*

### *Background*

We performed a limited scope review of complaint and claims handling practices of Provident Companies, Inc. ("Provident" or the Company). Paul Revere Companies were excluded from the review. The work was performed at Provident's home office in Chattanooga, Tennessee from May 17 through May 21, 1999. Areas reviewed included claims and complaint handling procedures, appeal procedures, customer service, compliance audits and a review of market conduct examinations performed by various jurisdictions in the last five years. The work focused on the disability income line of business. Additionally, the work included evaluating the complaint and claim handling procedures and appeals procedures of Provident and UNUM, to the extent the information was available. Trends relating to complaints, appeals, reopened claims, and lawsuits filed for both companies can be found in Exhibit A of this report.

### *Compliance Program Structure*

We requested and received organizational charts ( See Exhibit B) and explanations of Provident's current compliance program structure as well as that of the future combined companies. Currently, Provident has two individuals dedicated to compliance matters. They are: Chris Parrott, the acting Chief Compliance Officer and Jean Phillips, who is responsible for maintenance of complaint records. Mr. Parrott replaced Richard Lang upon his departure from the Company on February 10, 1999. Both individuals are located in the home office in Chattanooga. Before his departure, Mr. Lang wrote and distributed a compliance manual that will be discussed in more detail in the section of this report entitled Market Conduct Compliance Manual. The Compliance Assistant at the Worcester location (Paul Revere business) left the Company on May 7, 1999 and has not been replaced.

The proposed UNUMProvident organizational structure contemplates an increase in compliance staff as compared to the current Provident structure. Ms. Joan Sarles Lee, the current Compliance Officer for UNUM will be leading the program as the Chief Compliance Officer for the combined companies. She will report to the General Counsel and have responsibility for all locations. Additionally, she plans to have two managers and six other staff reporting to her (Exhibit B). Most of the staff is currently in place, but some positions remain open. There has been no formal written plan developed as of yet to integrate the compliance functions, set goals or otherwise implement a comprehensive compliance program. Ms. Sarles Lee anticipates a proactive approach to addressing compliance issues and integration of

compliance into everyday business processes. She also contemplates the development of internal review procedures in applicable business areas to monitor compliance as well as the continuation of internal audit involvement in compliance reviews.

There will be a significant amount of work related to the development of a comprehensive program. A comprehensive program typically has four main areas where processes should be present and operating effectively. These are: 1) Board of Directors and Management Participation and Support, 2) Risk Assessment and Internal Controls, 3) Compliance Policies and Procedures, and 4) a Compliance Officer and Compliance Committee. Provident's current program does not appear to contain all of these processes. The establishment of a complete and effective compliance program of this nature could require several years of development. Additionally, the lack of a documented plan and resources in the compliance area at Provident may be an indication that Provident's corporate culture does not place a high degree of emphasis on these matters.

#### ***Market Conduct Compliance Manual***

We received and reviewed a document entitled "Market Conduct Compliance Manual" dated April 23, 1998 (see Exhibit C). The manual was written by the former Chief Compliance Officer, Richard D. Lang. The manual contains the following subjects related to market conduct compliance:

- Statement of Corporate Values
- Goals
- Responsibility for Compliance
- Ethical Market Conduct
- Screening, Training and Compensation
- Monitoring
- Sanctions
- Regulatory Inquiries
- Prohibited Sales Practices
- Sales Illustrations
- Policy Delivery
- Advertising Guidelines
- Complaint Handling and Tracking
- Replacement Transactions
- Market Conduct Examination Procedures
- Privacy Policy

Provident has a "Market Conduct Compliance Manual" which addresses high level aspects of its compliance program. It does not, however, contain a sufficient level of detail regarding items such as common state regulations, including unfair trade practices acts, unfair claims settlement acts, complaint response requirements, and the like.

We noted that several important market conduct areas were not addressed in this manual. These areas are producer licensing, underwriting and rating, claims handling, policyholder service and monitoring of third-party administrators (TPA). Provident extensively uses GENEX, a TPA, to assist in its claims handling process.

The following summarizes the areas in the "Market Conduct Compliance Manual" deemed pertinent to the review of complaints related to disability income claims.

#### Monitoring

In this section, the manual addresses how performance guidelines related to compliance for producers and employees will be monitored. It also states that the Internal Audit Department, at the direction of the Compliance Officer, will implement a program to conduct periodic compliance audits. We requested and reviewed copies of these audits. A summary of the content of these audits can be found in the Compliance Audit section of this report. The manual also states that any producer or employee who has reason to believe that another producer or employee has committed a compliance violation is required to report such violation to the Compliance Officer. Additionally, there is a toll-free Compliance Hotline for this use. We did not test the effectiveness or use of this Hotline. The manual further states that no producer or employee would be disciplined or otherwise treated adversely for raising legitimate concerns, questions or suggestions regarding compliance.

#### Complaint Handling and Tracking

This section of the manual addresses the handling and tracking of complaints, including information on the definition of a complaint, maintenance of the Complaint Register, follow up, appropriate response time, complaint reports to the Compliance Officer, record retention, and guidance on handling producer complaints. More detailed information on these procedures as well as a comparison to current procedures at UNUM will be addressed in the Complaint Procedures section of this report.

We cannot conclude on whether or not the principles, policies and procedures contained in the manual, other than complaint handling and tracking, are in place and operating effectively due to the limited nature of the work performed. Conclusions regarding complaint handling and tracking can be found in later sections of this report (Review of Company Complaint Registers and Detailed Complaint Testing).

### *Market Conduct Examinations*

The Company was asked to supply us with all market conduct examinations performed by any jurisdiction in the past five years. Copies of examination reports from Connecticut, Illinois, Kentucky and Nevada were received and reviewed. The following summarizes the scope, time periods and findings in these reports relevant to claims handling and complaints handling.

State	Scope	Examination Period	Findings
Connecticut	Solicitation of new business, advertising, agent supervision, agent licensing and appointment, complaint and claim handling	January 1, 1995 through December 31, 1997	No adverse findings regarding claims or complaints handling.
Illinois	Producer licensing and production, policy forms and advertising materials, non-forfeiture benefits, claims, underwriting and complaints	January 1, 1997 through December 31, 1997	Improper use of the word "final" on payment checks, drafts or letters, failure to provide written explanations for claim delays, failure to provide notice of availability of the Department of Insurance for assistance, failure to respond to the Department of Insurance in the time required
Kentucky	General operations, licensing and appointment, advertising and sales, filing and approval of policy forms, underwriting and rating practices, claims handling practices, non-forfeiture benefits administration, complaint handling and local government premium taxes	January 1, 1995 through December 31, 1996.	No Kentucky fraud statement on claims and no findings related to complaint handling
Nevada	Marketing, advertising and agent matters, statutory filings, claims handling systems, complaint procedures, group life and health operations, individual health operations, unclaimed funds and premium taxes	January 1, 1992 through December 31, 1994.	No adverse findings regarding claims or complaint handling.

Several states noted adverse findings in their reports, attributable to other lines of business and/or functional areas. The reports from the States of Kentucky, Connecticut and Nevada all noted producers acting as agents of the Company who were not appointed, as required. Additionally, the State of Illinois report noted numerous violations of its unfair claims settlement practices act including:

- failure to pay interest on life claims
- failure to adopt and implement reasonable standards for the prompt investigation and settlement of claims
- failure to effectuate prompt, fair and equitable settlement of claims
- failure to affirm or deny coverage within a reasonable time after proof of loss statements were completed
- failure to provide claim forms within 15 days from the date requested
- failure to explain how a claim is adjudicated including charges submitted, eligible and ineligible expenses
- failure to provide all available non-forfeiture options

It should be noted that with the exception of the Illinois report, the emphasis in the majority of the reports was on Provident's life and health business rather than disability income claims and complaints. These findings indicate that there may be some cause for concern regarding claim handling practices and licensing and appointment procedures.

### *Compliance Audits*

We received and reviewed a binder entitled "Compliance Audits and Responses". Richard Lang, the former Compliance Officer of Provident compiled this binder. The binder contained thirteen compliance audits performed by the Internal Audit Department under the direction of Mr. Lang. The audits were performed between December 24, 1997 and December 3, 1998. We noted one audit related to complaint handling and one related to life claims handling, but none were related to disability income claims. The Complaint Handling report covered the time period of January 1 through June 30, 1998 for both the Chattanooga and Worcester (Paul Revere business) locations. Findings of this audit included a recommendation that Provident improve the completeness and accuracy of complaint files and responses, as well as complaint register data. There was also a recommendation that adherence with required response times be improved.

### *Claims and Appeals Procedures*

#### Claims Procedures

We requested claims handling procedures manuals from both Provident and UNUM for review and comparison purposes. Provident does not have a written claims handling procedures manual. Insurers typically develop and periodically update a claims handling procedures manual in hard-copy or electronic format. Provident provided us with a box labeled "Claims Training Materials" that we reviewed on a

high level basis for compliance related guidance, noting none of significance. The materials consisted largely of memoranda from management regarding the handling of certain types or aspects of a claim. The information was often medical or administrative in nature and did not address such compliance topics as response times, claims processing, communication to claimants regarding processing delays, and the like. Further, an internal audit report dated March 17, 1997 recommended that documented administrative claims guidelines be developed. Claims management agreed with the recommendation and its intention to implement it. Management has stated its intention to create a written manual after the merger is completed. Further, an internal audit report dated March 17, 1997 recommended that documented administrative claims guidelines be developed. Claims management agreed with the recommendation and indicated its intention to implement it. UNUM claims handling procedures manuals for Individual Disability Income and Short-Term Disability were received and reviewed on a high-level basis.

#### Appeals Procedures

We requested appeals procedures manuals from both Provident and UNUM for review and comparison purposes. Provident responded that the only appeals manual maintained was related to ERISA group business. Appeals on individual business or non-ERISA group business are handled on a case-by-case basis by claim management. Provident's ERISA group appeals manual consists of questions and answers relating to the processing and appeal of ERISA group claims as mandated by the federal government. It also contains information regarding the structure and purpose of the appeals committee. This committee is used for ERISA regulated business only.

#### *Complaint Handling Procedures*

We received and reviewed written complaint handling procedures for both Provident and UNUM.

The procedures were substantially similar in the following respects:

- Both have centralized complaint tracking in the legal department of the company
- Complaints are date stamped in the legal department rather than at the actual place of receipt, which may be in a business area such as claims, underwriting etc.
- The business areas are responsible for responding to the complaints related to their functions.
- Both company's procedures mandate that periodic reports of complaint activities be given to management
- The definition of complaint is included in the procedures and is consistent with the NAIC definition
- Comparable guidelines exist regarding the content of letters sent in response to complaints

- Both companies require a 10 business day response time absent a specific requirement from a state department of insurance

The procedures differed in the following respects:

- UNUM tracks both written and verbal complaints on their complaint register, while Provident tracks only written complaints.
- UNUM has a designated "complaint coordinator" in each business area (such as claims, underwriting, etc.) who is responsible for researching and responding to all complaints. Provident has no particular designee with this function.

The procedures outlined for UNUM and Provident are substantially similar.

### *Review of Company Complaint Registers*

We received and reviewed copies of the complaint registers for the period January 1, 1996 through March 31, 1999 from both Provident and UNUM. The registers were reviewed for both content and format. As noted in the previous section, while UNUM records all complaints, including verbal complaints, Provident records only written complaints. Therefore, a comparison of the number of complaints would not be appropriate. Both registers contain Department of Insurance and consumer direct complaints.

As the State of Maine has no specific requirement regarding format, the National Association of Insurance Commissioners (NAIC) model regulation was used as a guide. The following chart summarizes the elements required by the model regulation and whether the element is present in the respective company complaint registers.

Model Regulation Requirement	Provident Log	UNUM Log
Records kept on a calendar year basis	Yes	Yes
Complaints classified by function	Yes	No (A)
Complaints classified by reason	No	Yes
Complaints classified by origin	Yes	Yes
Record includes company identification number	Yes	No
Record includes identification number of any agent, adjuster etc. involved in the complaint	No	No
Record includes insurance department identification number where applicable	Yes	Yes
Complaints classified by line of business	No (B)	No (B)
Record notes disposition of the complaint	No	Yes
Record has date received and date closed	Yes (C)	Yes
Record has state of origin	Yes	Yes

- (A) The complaints are classified by product center group which generally does not clearly identify the function as required by the model regulation (underwriting, claims, etc.)
- (B) The Provident complaints are classified by department which does not always delineate line of business as required by the model regulation (group life, group health, etc.). The UNUM complaints are classified by product center group which generally does not clearly identify the line of business as explained in footnote A.
- (C) It should be noted that the information contained in the complaint register for date received relates to the date the complaint was received in the law department. For complaints that are received in other areas of the Company, we were unable to determine when the complaint was actually received due to lack of date stamps.

The content and format of the registers are substantially similar between the Companies.

#### *Detailed Complaint Testing*

We received Provident's complaint register as noted above. Complaints relating to claims handling of disability income policies were isolated. The population of these complaints was 1,113. We then selected a statistical sample for review of 46 files. Twenty-eight (61%) of the files were found to have exceptions. The following chart summarizes the number and percentage of files found to have exceptions, by category. In some cases, a single file contained more than one exception. As numerous states were involved, the complaints were tested against the standards and expectations outlined in the NAIC Market Conduct Examiners Handbook. Please refer to Exhibit D for detailed information on specific complaint file findings.

Standard Tested	Number of Exceptions	% of Exceptions in Applicable Files
Response time is within the time frame required or requested by the state department of insurance	11	27%
Adequate documentation is maintained in the file	6	13%
Response fully addresses the issue(s) raised	10	22%
Company procedures were followed	18 (A)	39%
Where complaint was due to denial of a claim, specific policy provisions were cited	7	24%
The response letter contains Company "contact information"	6	13%

- (A) All of these exceptions related to Provident's internal procedures mandating that complaints be responded to within 10 business days of receipt.



It was noted that for the sample reviewed, it took the Company an average of 12 business days to "respond" to complaints, which is deemed reasonable. "Respond" is defined as the date that a letter was sent to the complainant from the Company stating its position on the matter in question.

During our review of complaint files, we noted several issues that may be cause for concern regarding Provident's claim handling practices. As we were not requested to sample and test claim files, assumptions could not be made regarding whether these are pervasive issues in the adjudication of claims. Further examination and testing would be necessary to conclude on the matter. We noted the following potential issues:

- Reasonableness of determination of claimant's ability to return to work
- Suspension or termination of benefits when there were conflicting opinions of claimant's attending physician and the physician retained by Provident to perform an independent medical examination (IME)
- Determination to terminate benefits based on medical records contrary to the attending physician's statement that the claimant was unable to return to work
- Questionable application of policy provisions such as pre-existing conditions clauses, suspension of benefits due to "non-cooperation" of the claimant and notice of claim and proof of loss provisions
- Mandates regarding "appropriate care" to continue benefits that were not covered by the insured's health insurance plan or were otherwise unaffordable.
- Attempts to dictate treatment to the attending physician such as physical therapy or psychiatric services
- Determinations to terminate benefits based on peripheral information that has not been fully investigated, is not relevant or is unreliable, which may constitute unfair claims practices
- Fair and equitable treatment where "lump-sum settlements" were offered to claimants in lieu of continuation of benefits, especially long-term benefits
- Adverse determination letters did not contain any information regarding the credentials of the staff doctors and nurses that assisted the claim representatives in making the final determination

A more descriptive narrative of complaints reviewed and the issues involved can be found in Exhibit E.

### *Conclusion*

We recommend that the Bureau consider the following actions related to the merger of the Companies:

As outlined earlier in this report, we noted several potential market conduct issues during our review of complaint files and complaint handling procedures. As a condition of the merger's approval, the Bureau may want to consider conducting a full-scope market conduct examination of

UNUMProvident, placing particular emphasis on claims and complaint handling practices. The review should, at a minimum, include examination of disability income claims where benefits have been denied, suspended or terminated and claims where a "lump-sum settlement" was offered in lieu of continued benefits. The examination should be conducted within eighteen months of the merger.

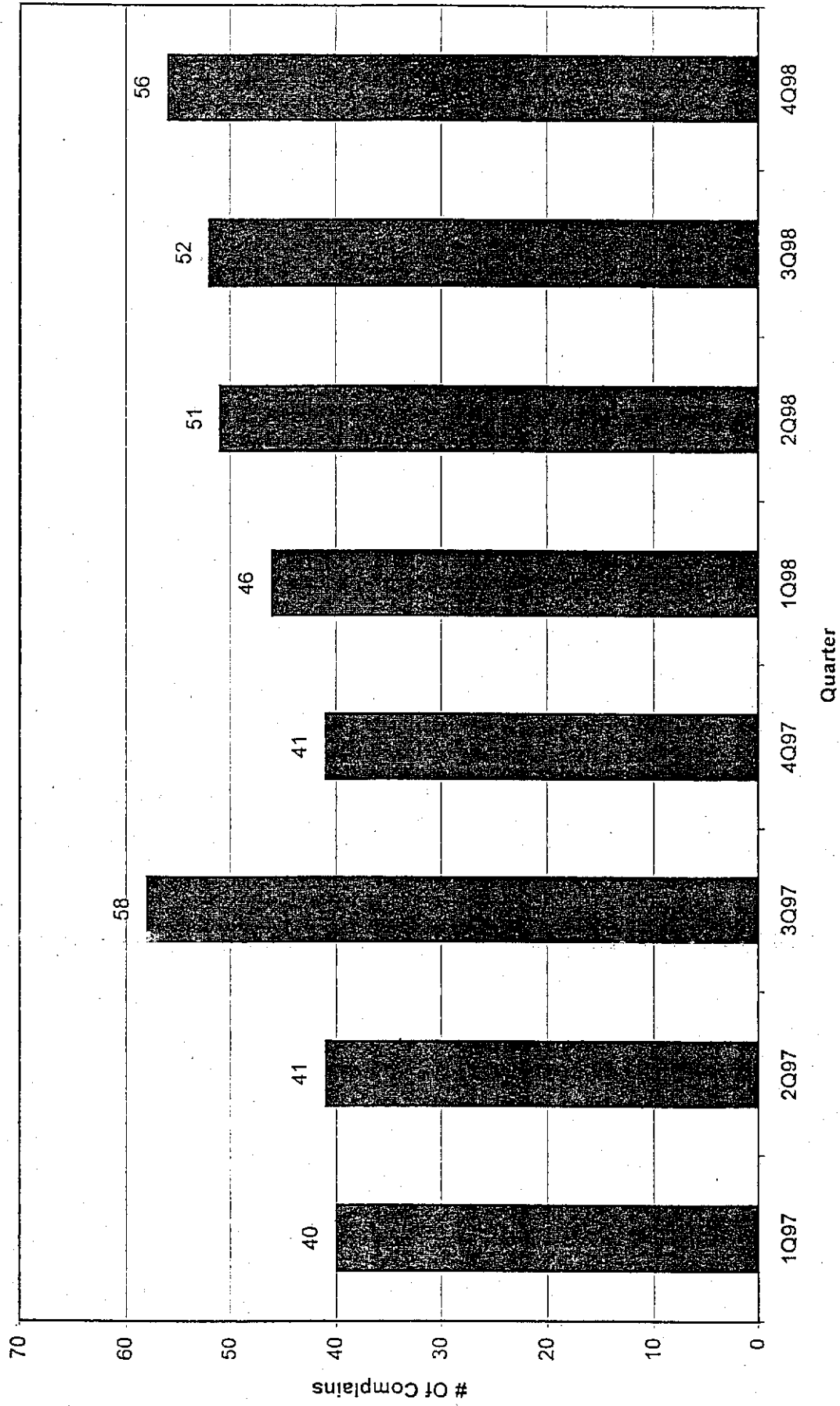
The Bureau may also want to consider mandating some or all of the following additional recommendations as a condition of approval of the merger:

UNUMProvident should:

- Develop and implement a written plan containing specific performance goals designed to achieve an effective and comprehensive compliance program. This plan should be presented to the Bureau within six months from the closing date of the merger. The Bureau should also require that the Company provide periodic updates of its progress relative to the achievement of these goals.
- Create and present to the Bureau a written claims procedures manual that includes compliance issues no later than six months from the closing date of the merger.
- Create and present to the Bureau a written appeals procedures manual that addresses all lines of business.
- Continue to perform compliance audits. These audits should include claims and complaints and be performed no less frequently than annually.
- Perform periodic audits of the activities of GENEX, its third party managed care company, to ensure appropriate, fair and compliant claims adjudication.
- Institute a procedure where each claim denial, suspension or termination letter contains language outlining the specific procedures to be followed should the claimant wish to appeal an adverse determination, as well as the credentials of the professionals involved in making the determination.
- Develop a system to ensure that the Company dates complaints received outside the legal department upon receipt.
- Develop a methodology to track and analyze verbal as well as written complaints.
- Update the Bureau regarding corrective actions taken relative to the findings in the compliance audit conducted in 1998 entitled, Complaint Management, within three months of the closing date of the merger.
- Evaluate the need to significantly expand the guidance in its Market Conduct Compliance Manual.

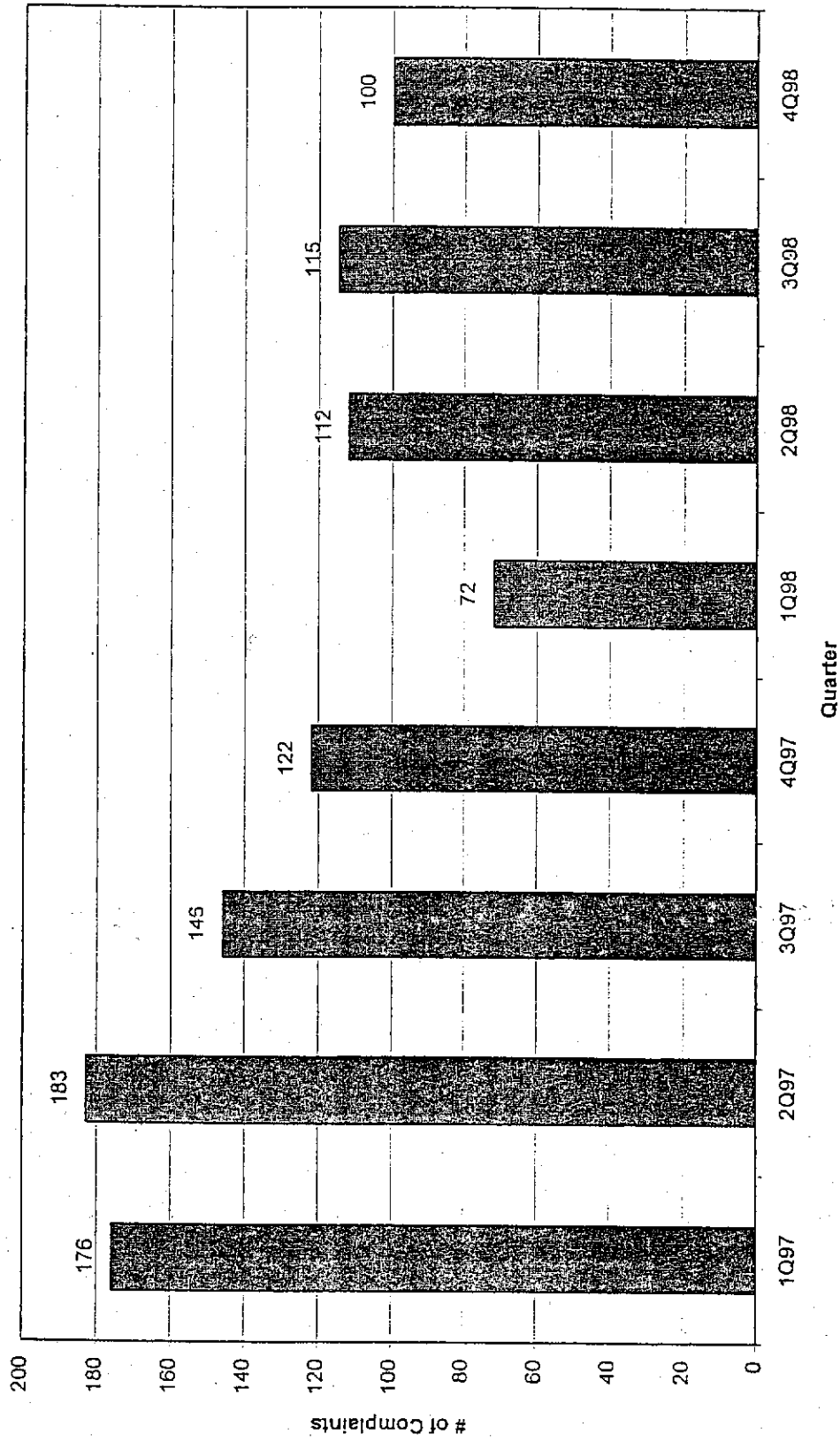
# EXHIBIT A

## Provident Complaint Trends, Representing Written Complaints Only



# EXHIBIT A

## UNUM Complaint Trends, Representing Both Written and Verbal Complaints



# EXHIBIT A

## Provident Appeals Trends Based on ERISA Data Only

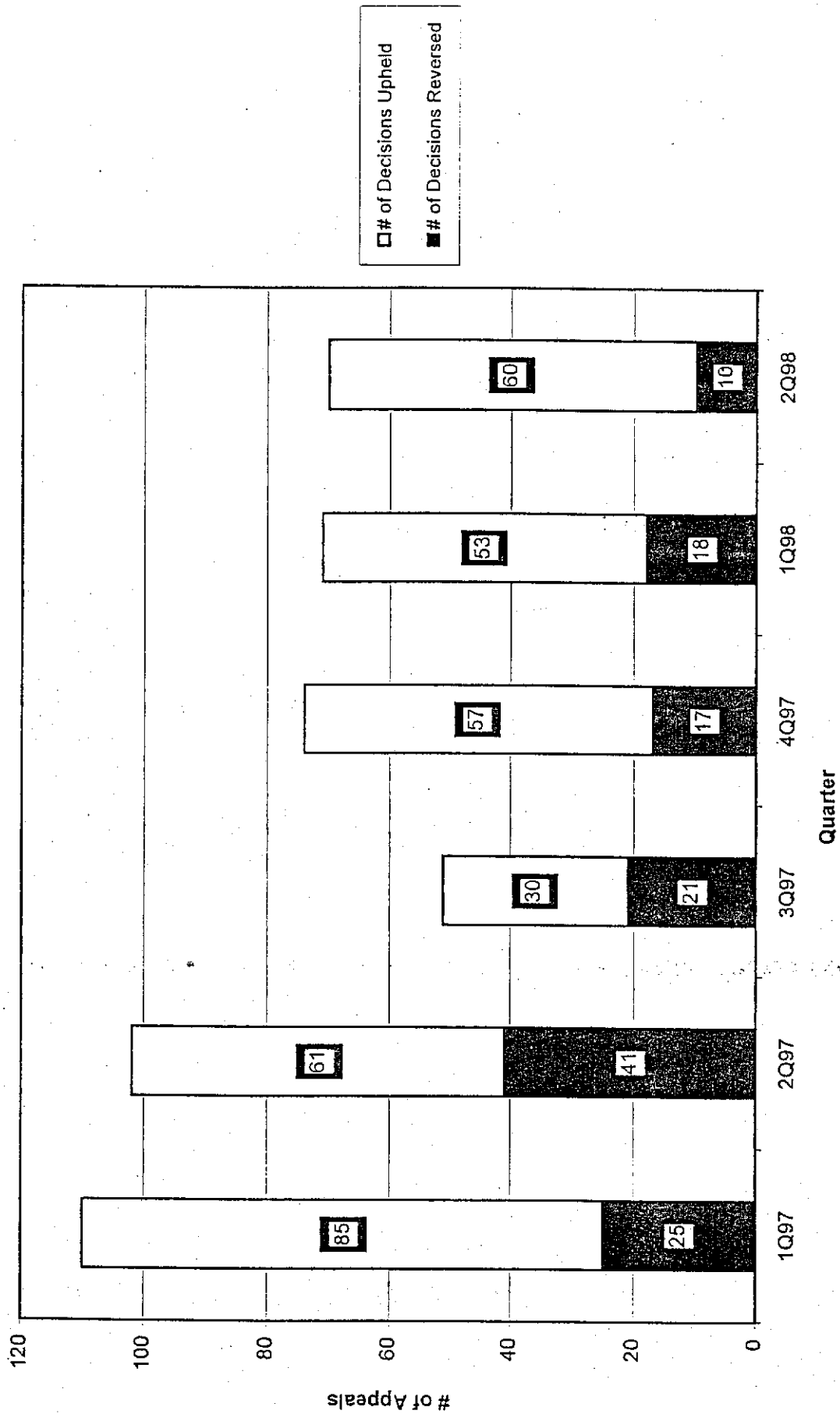
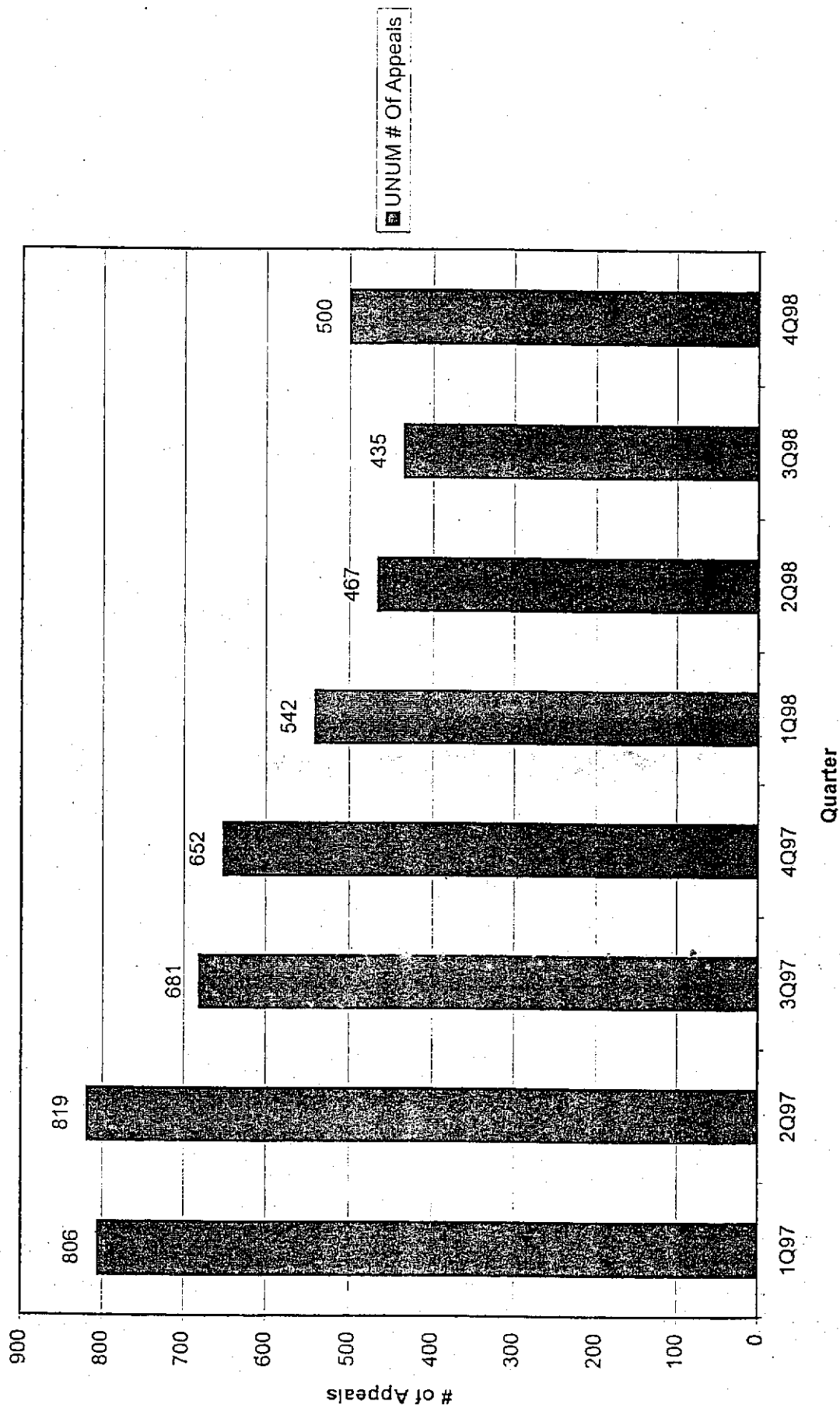


EXHIBIT A

UNUM Appeals Trends



# EXHIBIT A

## Provident Litigation Trends

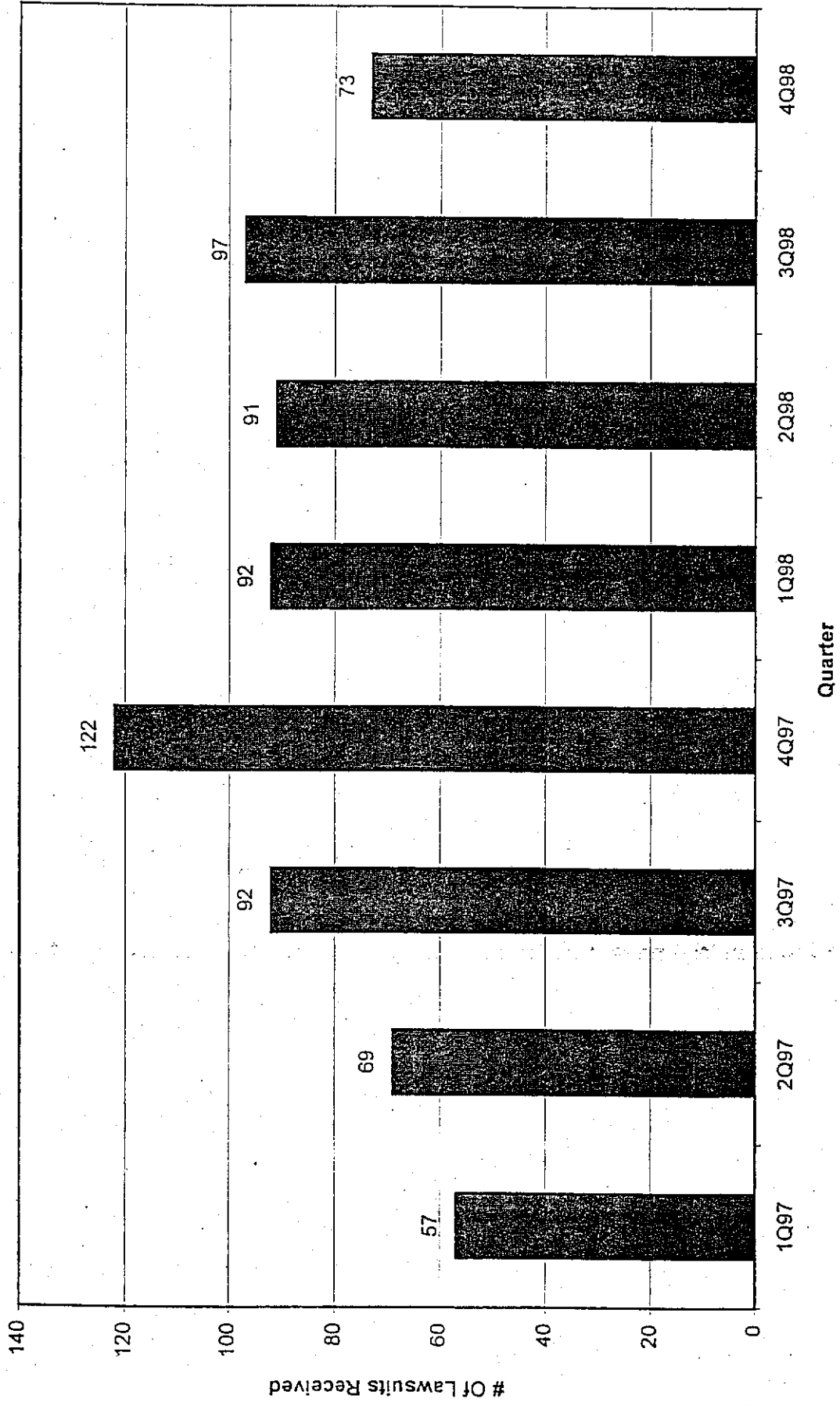
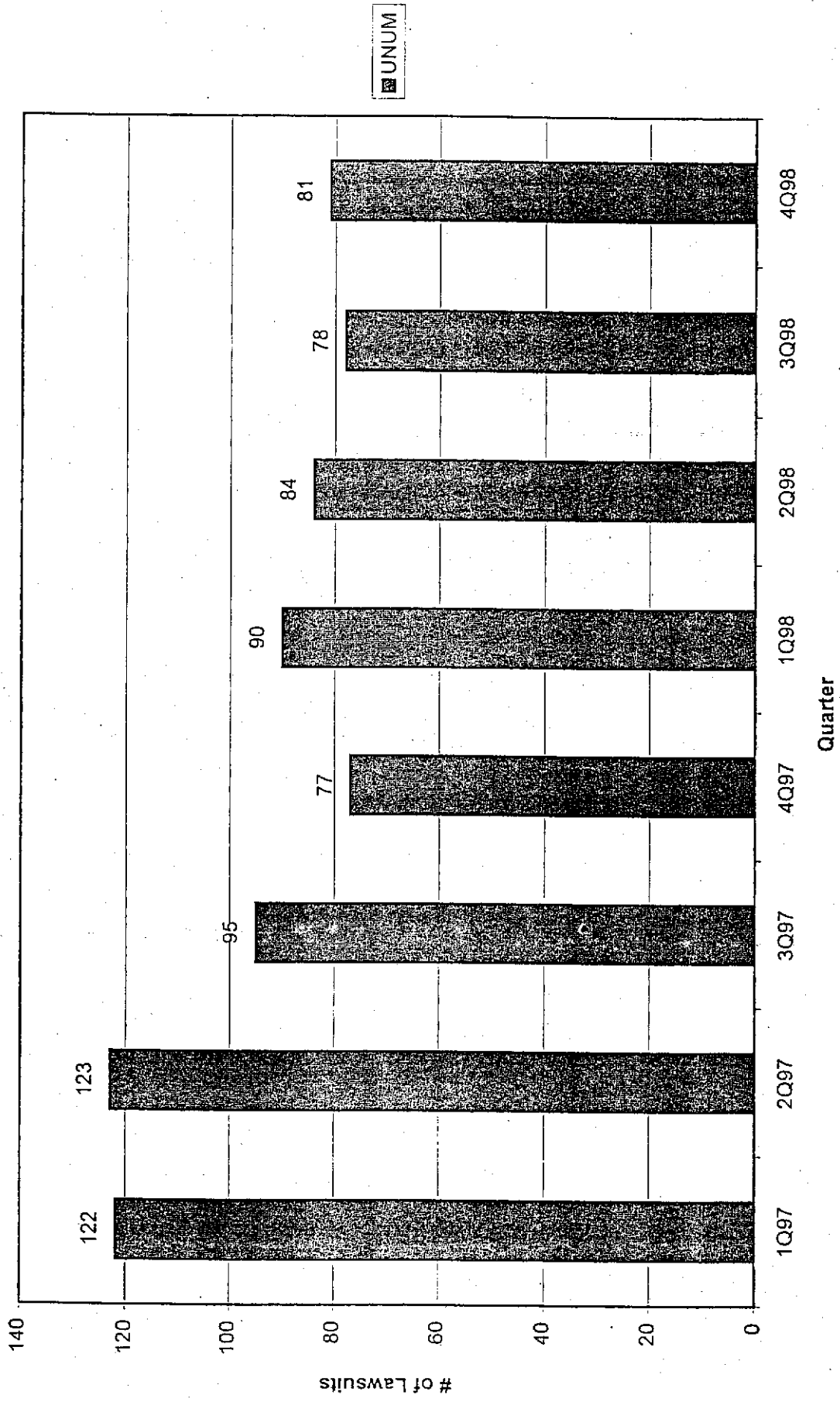


EXHIBIT A

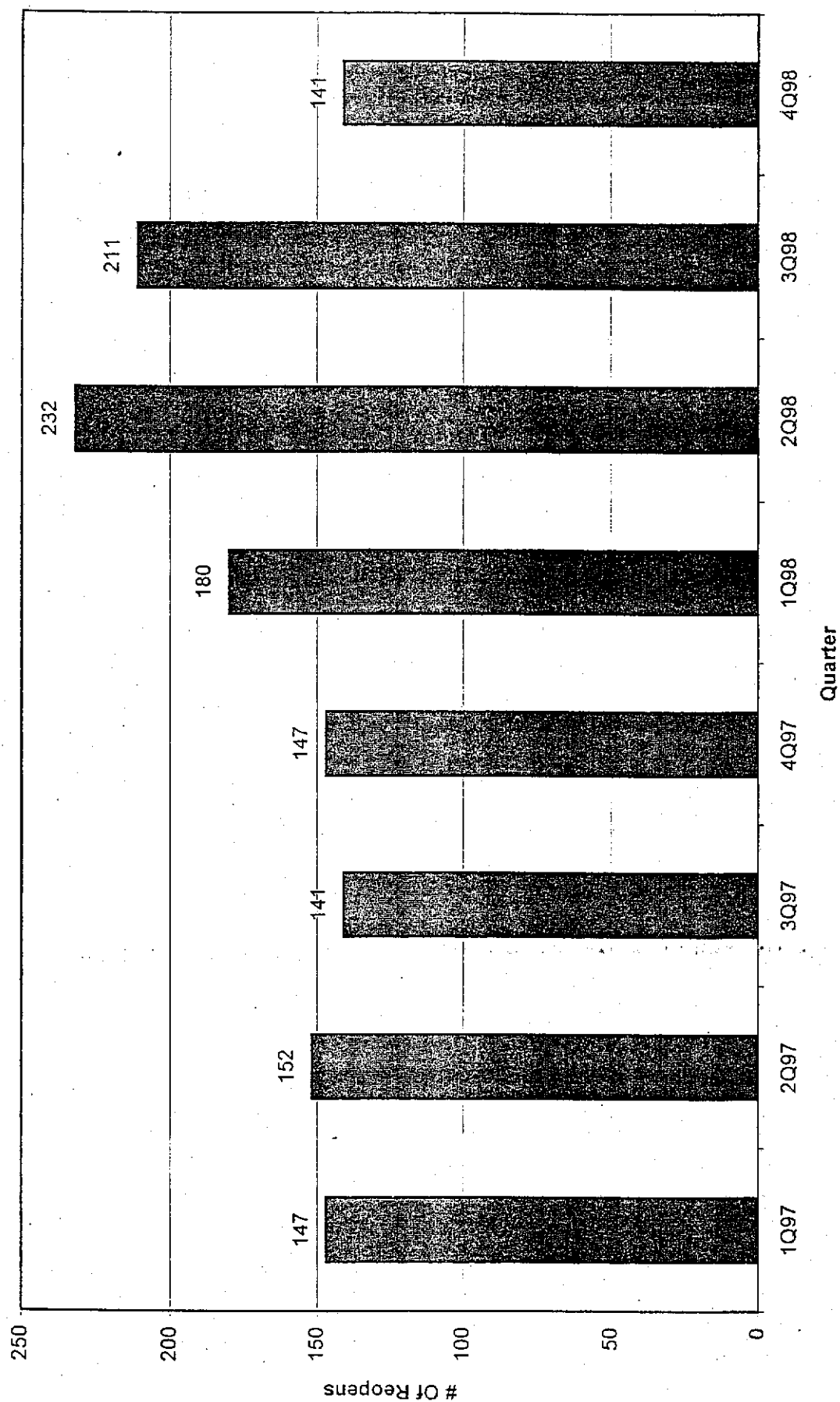
UNUM Litigation Trends





# EXHIBIT A

## Provident Reopen Trends, on LTD Policies, Including Both Individual and Group Coverages



# EXHIBIT A

## UNUM Reopen Trends

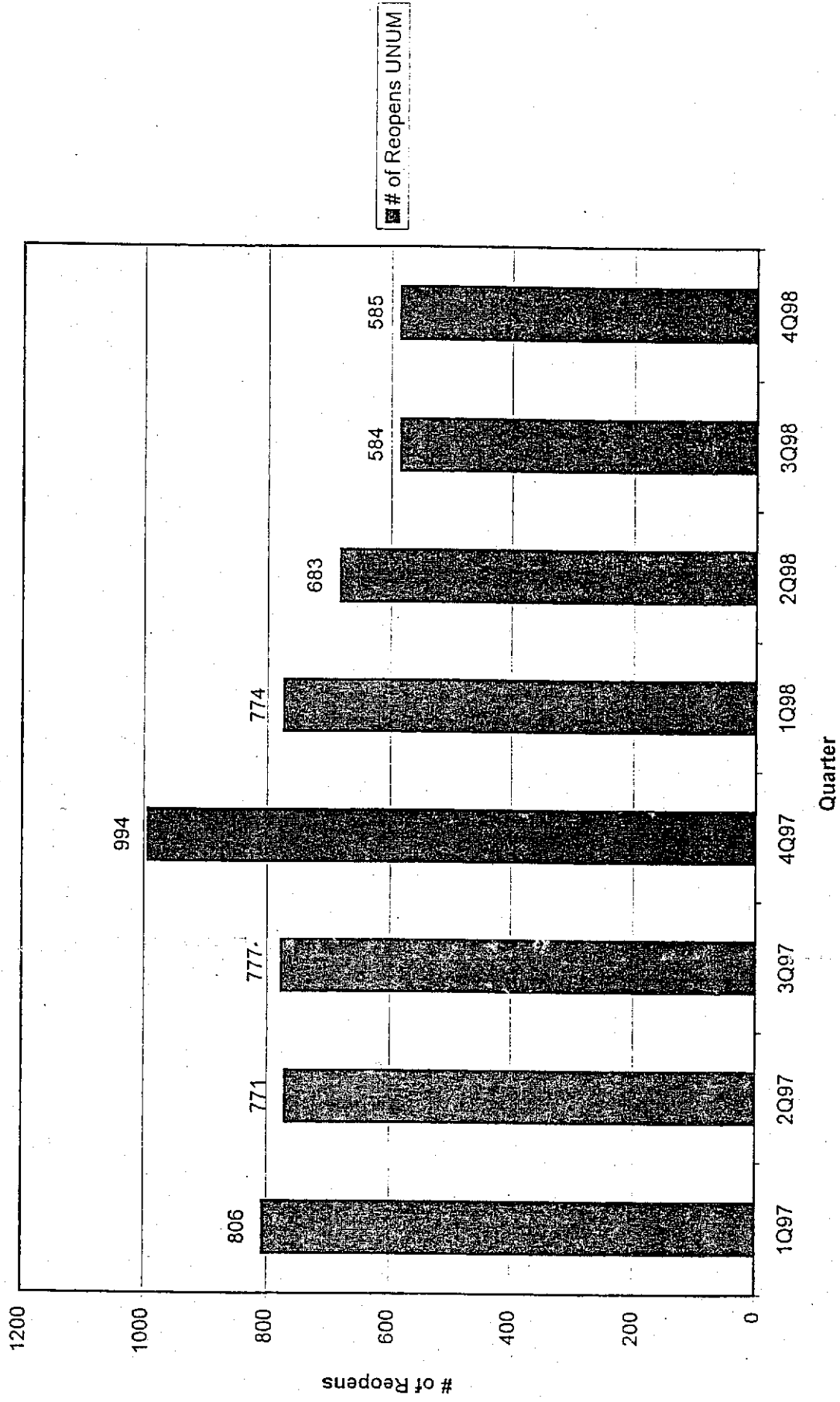


Exhibit B

Proposed Corporate Compliance Structure of UNUMProvident Corporation

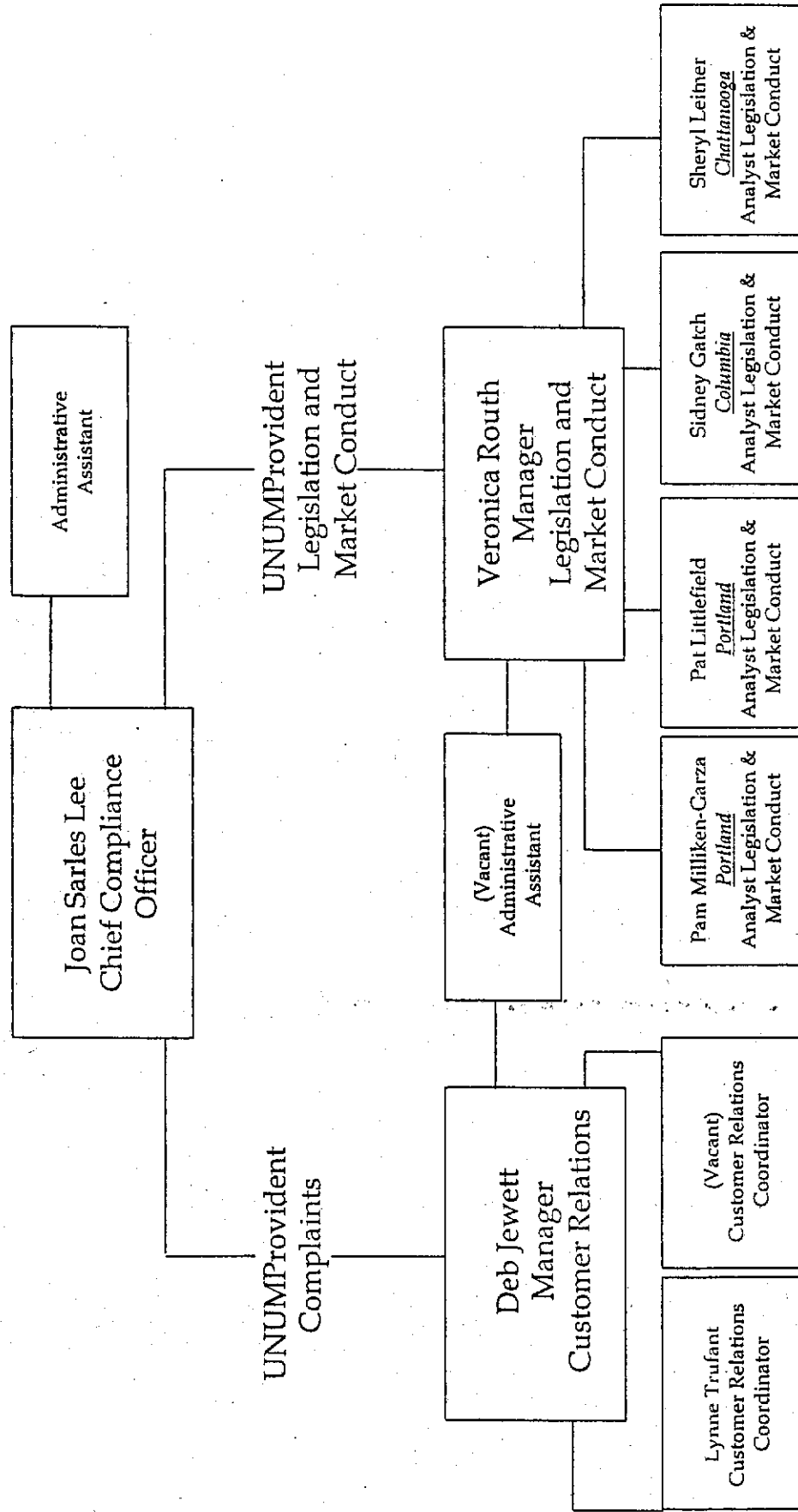
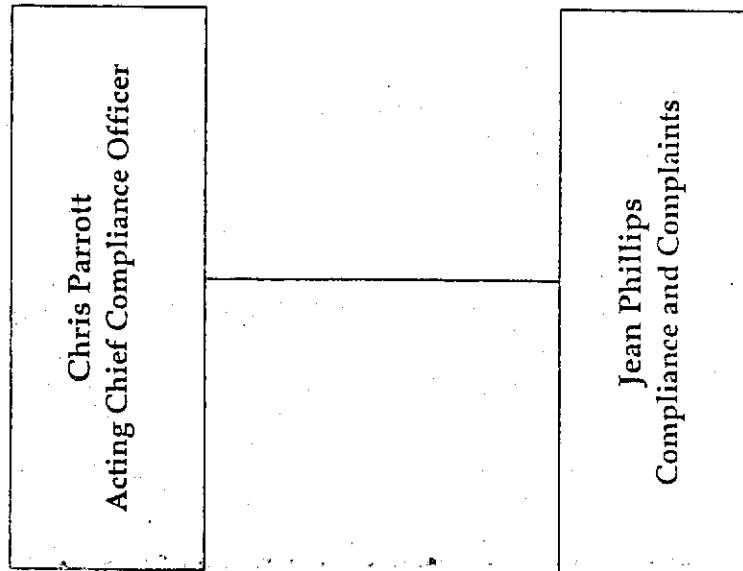


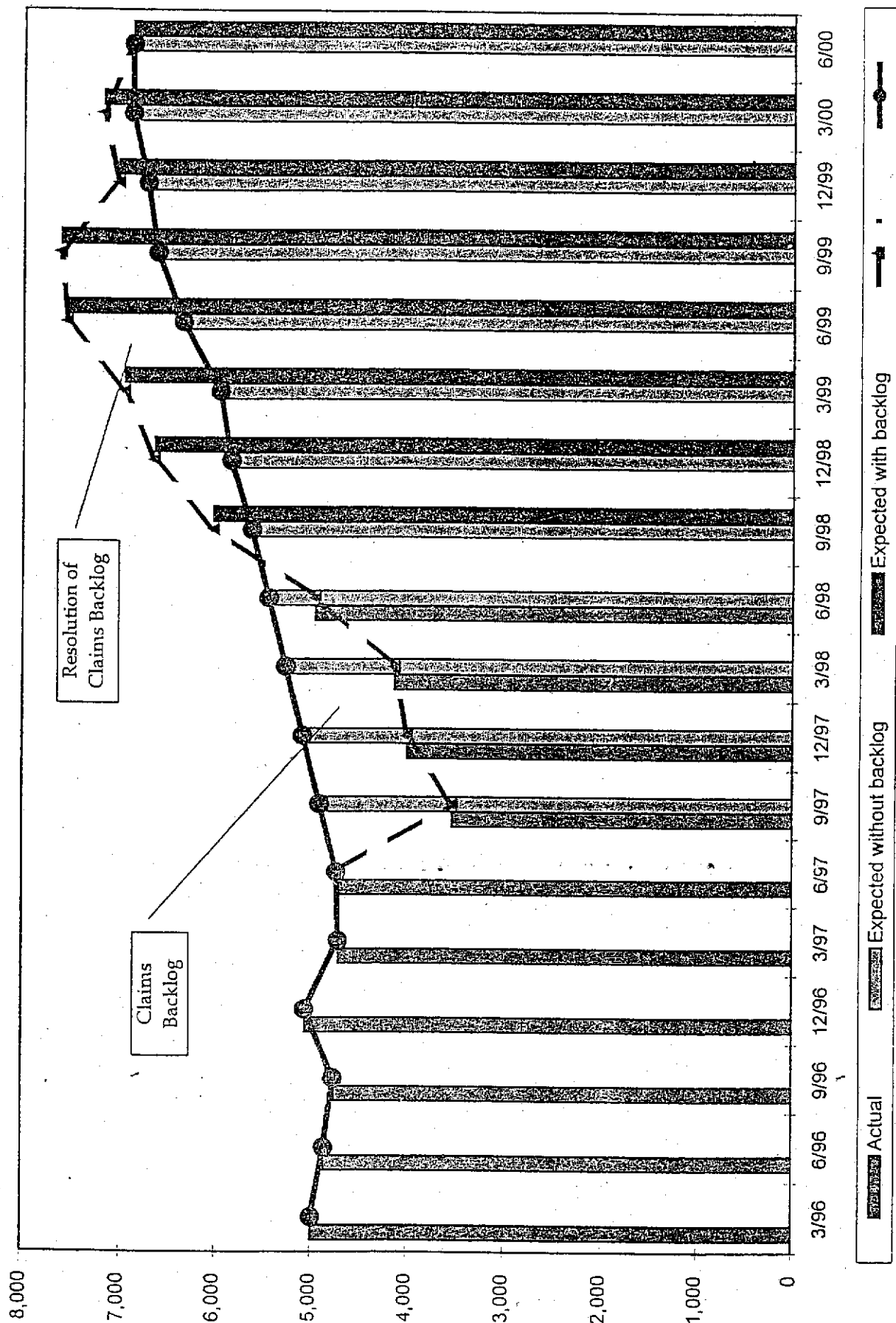
Exhibit B

Existing Corporate Compliance Structure of Provident Companies, Inc.



State of Maine Bureau of Insurance  
UNUM LTD Claim Buildup Reserve

Exhibit J





PROVIDENT

# MARKET CONDUCT COMPLIANCE MANUAL

**MARKET CONDUCT  
COMPLIANCE  
MANUAL**

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## STATEMENT OF CORPORATE VALUES

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Various subsidiaries of Provident Companies, Inc. (collectively referred to herein as the "Company") develop, market, sell, underwrite, issue and service insurance products for the benefit of individual, and corporate customers. These products provide protection from financial loss due to death or disability. The Company is committed to providing quality service to its individual and corporate customers.

The Company expects all of its employees, and all producers, consultants, brokers, and agents selling and distributing its products (hereinafter referred to as "Producers"), to act in accordance with the highest standards of personal and professional integrity in all aspects of their employment or appointment. In accepting employment or appointment with the Company, each employee and Producer is accountable for compliance with the law and with the guidelines and standards set forth in this Market Conduct Compliance Manual ("Manual"). This accountability requires each employee and Producer to know about and follow legal requirements to the best of his or her ability.

The Company also expects its employees and Producers to do business in accordance with our Corporate Values:

- ◆ Sound, responsible human relations are the foundation of our way of doing business. Therefore, we place primary value upon the people who are our customers, our employees, and our Producers.
- ◆ We are dedicated to serving individual and corporate customers and working with them to identify and respond to their needs. Our dealings with customers will be professional, yet courteous.
- ◆ Because all of our employees are important to our success, we will respect their individuality, provide opportunities for their growth and advancement, and encourage their understanding of our business plan and participation in decision-making.
- ◆ Our Producers are vital to our success. We are committed to responsive and responsible relationships with them.

## GOALS

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For over one hundred years, the Company has maintained a reputation for aggressive and fair competition, innovation, service, honesty and integrity. The Company is committed to serving its customers in accordance with the highest standards of business ethics and in conformity with all applicable laws and regulations. It is the Company's fundamental tenet that the Company, its employees, and its Producers will always comply with the law.

This Manual is intended to improve market conduct compliance, with the goal of:

1. Ensuring customer satisfaction with the sale and service of the Company's products;
2. Protecting the Company's image, reputation, and authority to do business;
3. Improving the profitability of the Company's business;
4. Enhancing business opportunities for the Company's employees and Producers; and
5. Avoiding disruptions to the Company's operations.

This Manual sets forth compliance responsibilities *in addition to* the responsibilities set forth in the Company's Employee Handbook, Statement of Business Practices, and any applicable Producer contracts or manuals.

This Manual sets forth the market conduct compliance issues facing the Company and provides guidelines for all employees and Producers to follow. Not every issue raised in this Manual will be encountered by every employee or Producer, nor does this Manual attempt to identify all compliance issues that employees and Producers may encounter.

This Manual applies to all employees and Producers of the Company and its subsidiaries. Additional copies are available upon request to the Compliance Officer.

## ETHICAL MARKET CONDUCT

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The Company has adopted in principle, and strongly supports, the American Council of Life Insurance (ACLI) Principles and Code of Life Insurance Ethical Market Conduct. Although the Principles and Code were intended to apply only to individually-sold life insurance and annuities, the Company expects its Producers and employees to apply these standards to all customers. The Principles and Code are reprinted below in their entirety.

### ACLI PRINCIPLES AND CODE OF LIFE INSURANCE ETHICAL MARKET CONDUCT

**PRINCIPLE 1:** *Insurers will conduct business according to high standards of honesty and fairness and will render that service to their customers which, in the same circumstances, they would apply to or demand for themselves.* To conduct its business according to high standards of honesty and fairness, an insurer will implement policies and procedures designed to provide reasonable assurance that:

- A. Insofar as individual products or those marketed on an individual basis are concerned, its distributors make reasonable efforts to determine the insurable needs or financial objectives of its customers based upon relevant information obtained from the customer and enter into transactions which assist the customer in meeting his or her insurable needs or financial objectives.
- B. It maintains compliance with applicable laws and regulations.
- C. In cooperation with consumers, regulators and others, it affirmatively seeks to improve the practices for sales and marketing of life and annuity products.
- D. The Principles of Ethical Market Conduct are reflected in company policies and practices.

**PRINCIPLE 2:** *Insurers will provide competent and customer-focused sales and service.* To provide for competent sales and service of life and annuity products, an insurer will develop policies and procedures designed to provide reasonable assurance that:

- A. Its distributors are of good character and business repute, and have appropriate qualifications and experience.
- B. Its distributors are duly licensed or otherwise qualified under state law.

## ETHICAL MARKET CONDUCT (continued)

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- B. Materials presented as part of a sale are comprehensible in light of the complexity of the product being sold.
- C. It maintains compliance with applicable laws and regulations related to advertising, unfair trade practices, sales illustrations and other similar provisions.
- D. Illustrations of premiums and considerations, costs, values and benefits, are accurate and fair, and contain appropriate disclosure of amounts which are not guaranteed and those which are guaranteed in the policy or contract.

**PRINCIPLE 5:** *An insurer will provide a means for fair and expeditious handling of customer complaints and disputes. To resolve any complaints and disputes that may arise concerning market conduct, an insurer will develop policies and procedures designed to provide reasonable assurance that:*

- A. Complaints are identified, evaluated and handled in compliance with applicable state law and regulations related to consumer complaint handling.
- B. Good faith efforts are made to resolve complaints and disputes without resorting to civil litigation.

**PRINCIPLE 6:** *Insurers will maintain a system of supervision that is reasonably designed to achieve compliance with these Principles of Ethical Market Conduct. An insurer will develop or assign responsibilities designed to provide reasonable assurance, as appropriate to the insurer's distribution system, that:*

- A. It establishes and enforces policies and procedures reasonably designed to comply with the Principles and Code of Ethical Market Conduct.
- B. There is an adequate system of supervision of the market activities of its distributors and employees involved in the sales process in order to monitor their compliance with these Principles and Code and applicable laws and regulations.
- C. Compliance training sessions are conducted for employees involved in the sales process and instruction on the company's compliance requirements is made available to all distributors.
- D. Policies and procedures provide for auditing and monitoring of information related to sales practices of its employees involved in the sales process and distributors.

## MONITORING

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This Manual sets forth guidelines for the minimum performance required of all employees and Producers regarding compliance issues. Each business unit will be monitored to confirm that the guidelines are being observed.

### Internal Audits

The Internal Audit Department of the Company will, at the direction of the Compliance Officer, monitor the Company and its Producers to determine areas of non-compliance and implement a program of periodic compliance audits that will evaluate compliance with the Company's policies and procedures set forth in this Manual.

### Monitoring Procedures

The Compliance Officer will design and supervise a program of procedures designed to detect improper or unsuitable solicitation or sales activities. The procedures may include written customer communication materials such as confirmations, welcome brochures or periodic statements that are designed to elicit responses from customers to determine whether they were properly solicited by a Producer who sold a suitable product and whether full disclosure was made about the nature of the product and its cost and benefits.

### Reporting

Any Producer or employee who has reason to believe that another Producer or employee has committed a compliance violation are required to report such violation to the Compliance Officer. Anyone reporting such a suspected violation may request anonymity or may anonymously report the violation via a toll-free **Compliance Hotline (1-800-821-1693)**. No employee, Producer or individual will be disciplined or otherwise treated adversely for raising legitimate concerns, questions, or suggestions regarding compliance issues. The Compliance Officer will review all reports of serious compliance violations with senior management.

## REGULATORY INQUIRIES

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Should any state insurance department or other local, state, or federal regulatory authority contact or visit you, you should immediately notify the Compliance Officer. In addition, in the event you become aware of any violation of any law, regulation, or Company procedure, you must immediately report such violation to the Compliance Officer.

Also, Producers who are appointed and contracted by the Company must immediately notify the Company if they:

1. Are the subject of any inquiry or investigation by any insurance or securities regulatory agency or self-regulatory body or required to testify before any such agency or body;
2. Are a defendant or respondent in any litigation, proceeding or arbitration alleging violation of any insurance or securities statute or regulation;
3. Are the subject of any injunction, suspension, fine, cease and desist order or other disciplinary action by any insurance or securities regulatory agency;
4. Have any registration, license, permit, certification or membership denied, suspended, revoked or restricted by any insurance or securities regulatory agency;
5. Are the subject of any contempt proceeding or civil judgment related to Producer's insurance business;
6. File for bankruptcy protection or have involuntary bankruptcy proceedings filed against them; or
7. Are the subject of any felony arrest, summons, arraignment, indictment or conviction, or have pleaded guilty or no contest to any felony offense.

## PROHIBITED SALES PRACTICES (continued)

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### **Improper Sales Illustrations**

Producers may use only sales illustrations or illustration software approved by the Company, which may not be altered or abbreviated in any manner.

### **Rebating**

Producers may not split or share any commission or other compensation with an unlicensed person or entity (except assignment to an agency where allowed by law). Also, no incentive of any value may be paid or given to an applicant to induce the purchase of a Company product.

### **Misrepresentation**

Producers may not make any inaccurate or misleading statement, either orally or in writing. All Company products must be clearly identified as insurance products during solicitation. Producers must fully disclose all relevant benefits and limitations of Company products.

### **Unapproved Advertising**

Producers may not use advertising that has not been approved by the Company prior to its use if such advertising could result in a sale of a Company product.

### **Lack of Suitability**

Producers may not recommend the purchase of a Company product without considering their client's needs, risk tolerance, and financial resources.

### **Abuse of "Free Look" Rules**

Producers may not circumvent the "free look" privilege by failing to promptly deliver a policy and advise a client that he/she is entitled to a specific period of time to review the policy in order to decide whether to accept the policy.

## PROHIBITED SALES PRACTICES (continued)

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- To sign the name of another person, such as an applicant, insured, policy owner, beneficiary, assignee or otherwise, whether or not such person consents thereto.
- To be assignee, owner or beneficiary of any policy issued by the Company, other than a policy on the Producer or on a member of the Producer's family.
- To enter into contracts with sub-producers for the solicitation of the Company's products, or to share Company commissions, with anyone not licensed and appointed by the Company.
- To represent the Company in any manner whatsoever before any State Insurance Department, or official thereof, or any governmental agency; such matters must be submitted to the home office to the attention of the Compliance Officer.
- To charge for services that are undertaken or rendered to any applicant, policy owner, or beneficiary or assignee such as explaining the terms of a policy, making application for a policy, collecting the policy proceeds, submitting proofs of claim, or any other similar service, unless approved by the Company in writing.
- To solicit applications for products not approved by the appropriate State Insurance Department.
- To undertake any action on behalf of the Company not authorized in writing by an officer of the Company.



## SALES ILLUSTRATIONS (continued)

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4. If the illustration shows any non-guaranteed elements, they are to be clearly labeled as such.
5. The illustration must include a statement indicating that benefits and values are not guaranteed, the assumptions on which they are based are subject to change, and the actual results may be more or less favorable.
6. The illustration cannot represent in any way that premium payments will not be required for each year of the policy in order to maintain the illustrated death benefits, unless true.
7. The terms "vanish" or "vanishing premium" or a similar term cannot be used.
8. The requirements for individual life insurance sales and for sales of Voluntary Benefits life insurance policies are different:

### **Individual Policies**

In the sale of individual policies, the Producer will have the software to produce the illustration for the sale of the life insurance policy. The policy application and the illustration will be mailed to the Company. The illustration must be signed in accordance with the regulation. The Producer and the applicant must sign the illustration. Once received in-house, the basic illustration will be compared with the application. If no illustration is used by the Producer or if the policy is applied for other than illustrated, the Producer shall certify to that effect on a waiver form. If the signed illustration or the waiver form is not received, the application will not be processed until the signed illustration is received. If there is a discrepancy between the signed illustration and the policy as issued, a revised illustration must be produced. The Company will produce the revised illustration if the discrepancy between the policy and the illustration is something that occurred in-house. If the discrepancy is the result of a Producer's error, the Producer will be required to produce the revised illustration.

## POLICY DELIVERY

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Producers are encouraged to deliver policies and accompanying forms to policyholders within 10 days of receipt from the Company. Hand delivery is strongly recommended (both to ensure receipt and solidify the client relationship). However, where hand delivery is highly impractical, mail delivery is acceptable.

For the Producer's own protection, proof of delivery should be obtained at the time of delivery of the policy and maintained in the Producer's file. For mail delivery, a copy of the dated cover letter should be maintained in the Producer's file.

Failure to properly deliver a policy can lead to a policyholder allegation that the "free look" period never began (and therefore never ended). This can result in claims for premium refunds (and commission chargebacks) long after a policy was issued.

All accompanying forms must also be delivered to the policyholder, such as:

- Policy Summary
- Buyer's Guide
- Guaranty Fund Notice

Failure to timely deliver policies and accompanying forms may result in loss of commission. Repeated failure may result in disciplinary action, including termination of a Producer's appointment.

## ADVERTISING GUIDELINES (continued)

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### ADVERTISING FILE

The Market Communications Department of the Company shall maintain a permanent advertising file for each state containing a final approved version of all advertising used, along with the following information:

1. Dates used.
2. States in which used.
3. Manner of distribution.
4. Quantity used (by state).
5. Date obsoleted (if applicable).
6. Copy of notice regarding obsolescence (if applicable).

### GUARANTY ASSOCIATIONS

All 50 states, the District of Columbia, and Puerto Rico, have guaranty associations that protect against an insolvent or impaired insurer's inability to meet certain contractual obligations under life, health, or annuity contracts. The guaranty association coverages and exclusions vary from state to state. Although information about guaranty associations may be useful to insurance consumers prior to buying insurance, the Company cannot provide such information. In fact, it is a violation of law for the Company or any of its employees or Producers even to refer to the existence of guaranty associations prior to a sale. If prospective customers ask for information about guaranty associations, they should be referred to their state insurance department or guaranty association. In many states, the Company is required to deliver a guaranty association notice with the policy, which outlines the guaranty association coverages and exclusions in specific language prescribed by regulation.

## ADVERTISING GUIDELINES (continued)

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### SUBMISSION OF ADVERTISING AND SALES MATERIALS

1. Home Office Developed Advertising.

All new advertising (or modifications to existing advertising) must be submitted to Market Communications for review and approval prior to use. Comments will be provided to the submitting party. Do not use the advertising until formal approval has been obtained. A final version must be submitted prior to use.

Additionally, advertising intended for use in any state that requires filing with the Insurance Department cannot be used in that state until authorized by the Insurance Department.

2. Producer-Developed Advertising.

Producers must submit to Market Communications all new Producer advertising (or modifications to existing Producer advertising) for review and approval prior to use. Do not use the advertising until formal approval has been obtained. A final version must be submitted prior to use.

Additionally, advertising intended for use in any state that requires filing with the Insurance Department cannot be used in that state until authorized by the Insurance Department.

**An Advertising Checklist is found in Appendix "A" of this Manual.**

## COMPLAINT HANDLING AND TRACKING (continued)

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4. A copy of the response to the complaint must be sent to the Consumer Relations Administrator, including all attachments sent with the response.
5. If a full response to the complaint cannot be given within the time limits outlined in the complaint, an interim response must be sent to the State Insurance Department and/or complainant explaining the delay. This usually occurs in those situations where it is necessary to obtain additional information from various sources, such as a Producer, branch office, etc.
6. The Consumer Relations Administrator will follow up on outstanding complaints for a status report. The maximum turnaround time for responding to all complaints is ten (10) days, if not otherwise required by a State Insurance Department.
7. If you should receive a complaint directly from a State Insurance Department or complainant, please send the complaint immediately to the Consumer Relations Administrator or acknowledge the complaint and send a copy of the complaint and your acknowledgment to the Law Department. We must have a copy of any attachments received with the complaint.
8. When the complaint is resolved, Complaint Form G-2829 is to be completed and the original copy sent to the Consumer Relations Administrator.

### COMPLAINT REPORTS

A monthly complaint report will be provided to the Compliance Officer identifying the complaint activity for the prior month. The Compliance Officer will review the complaint report and discuss significant complaint activity with senior officers of the Company.

### RECORD RETENTION

Copies of the complaint, the resolution, any interim correspondence, and any supporting documentation will be maintained according to statutory requirements.

## REPLACEMENT TRANSACTIONS

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State laws and regulations mandate that Producers and insurers follow specific rules regarding notice, disclosure, signatures, and recordkeeping in replacement transactions. These regulations ensure that customers receive adequate and accurate information when one life or disability policy or annuity contract is replaced by another life or disability policy. These regulations also protect consumers against "churning" practices whereby cash value in an existing contract is utilized to purchase another policy from the same insurance company for the purpose of a Producer earning additional commissions or other compensation. In addition, these regulations protect against "twisting" practices whereby a Producer misrepresents policy benefits or company-related information to encourage movement to a different company's policy. **Replacements are seldom in the best interest of the policyholder and are strongly discouraged by the Company in most cases.**

Producers must be able to demonstrate an objectively reasonable basis for believing that a replacement will result in the benefit and betterment of the insured. Replacements must be in the best interest of the policyholder. No policy will be issued until all Company requirements and applicable state-mandated requirements are met.

### LIFE INSURANCE

The following section is a summary of the National Association of Insurance Commissioners (NAIC) model law regarding life insurance replacement transactions. (State laws vary considerably; Producers are responsible for knowing the requirements for each state in which they solicit business.) [A summary of replacement requirements for individual disability income policies follows later in this section.]

#### Definition

A replacement is any transaction in which a customer purchases a new life insurance policy and the Producer or the insurer knows or should have known that the customer's existing policy is or

## REPLACEMENT TRANSACTIONS (continued)

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### Duties of Producers

Producers must submit to the Company with, or as part of, every application:

1. A statement signed by the applicant stating whether the transaction involves a replacement.
2. A statement signed by the Producer stating whether the Producer knows a replacement is or may be involved in the transaction.

When the transaction involves a replacement, Producers must:

1. Give the customer a "Notice Regarding Replacement" when the application is taken.
2. Obtain the customer's signature on the Notice when the application is taken.
3. Sign the Notice.
4. Leave one copy of the Notice with the customer.
5. Submit one copy of the Notice with the application.
6. Keep one copy of the Notice for your files.
7. Obtain a list of all existing life insurance policies and annuities to be replaced by the proposed life insurance policy.
8. Identify and document all existing life insurance policies or annuities by:
  - \* name of the insurer; and
  - \* name of the insured; and
  - \* policy number (if there is no assigned policy number, list alternative identification such as the application or receipt number).
9. Leave copies of all printed or written sales materials used for the presentation with the customer, retain copies for your files, and submit copies to the Company.

## REPLACEMENT TRANSACTIONS (continued)

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### INDIVIDUAL DISABILITY INCOME POLICIES

The following is a summary of the section of the NAIC accident and sickness model law regarding requirements for replacement. One-half of the states have adopted this model law. (State laws may vary; Producers are responsible for knowing the requirements for each state in which they solicit business.)

#### Definition

A replacement is any transaction in which a customer applies for a new individual disability income policy and the producer or the insurer knows or should have known that a customer's existing accident and sickness coverage (whether group or individual) is or will be lapsed, forfeited, surrendered, or terminated.

#### Applications

Application forms must include a question designed to elicit information as to whether the insurance to be issued is intended to replace any other accident and sickness policy.

#### Duties of Producers

When the transaction involves a replacement, Producers must:

1. Furnish the applicant, prior to issuance or delivery of the policy, a "Notice to Applicant Regarding Replacement of Accident and Sickness Insurance."
2. Obtain the applicant's signature on the Notice.
3. Leave one copy of the Notice with the applicant.
4. Submit one copy of the Notice to the Company.
5. Keep the Notice for your files.

#### Duties of the Company

1. Inform all Producers and employees of the requirements for replacements.
2. Obtain copy of Notice for all replacement transactions.
3. Maintain copy of Notice in policy file.



## PRIVACY POLICY

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The Company collects, uses and retains personal information about those to whom we provide insurance protection. The Company conducts its business in a manner that reflects concern for each individual's right to privacy and the public's need for fairness in information practices. Accordingly, the Company will:

1. Request, use, retain and record only personal information that is necessary to conduct our business.
2. Request the required information directly from the individual to whom it applies from reputable sources such as credit reporting services.
3. Make reasonable efforts to assure that the information acted upon is accurate, relevant, complete and timely.
4. When requesting information about a prior refusal of insurance, request the reasons for any such action. The Company will not refuse an individual's application for insurance solely because of such prior action, but may do so upon independent inquiry into the reasons for such action.
5. Prior to requesting a consumer investigative report, notify the applicant that the Company may request a report and the individual's rights if such report is actually ordered. Information obtained from such a report may be retained by the reporting service and disclosed to other persons.
6. Prior to seeking information from a medical care provider, obtain the individual's written authorization.
7. Inform individuals applying for insurance as to any personally identifiable information that may be requested for purposes not directly related to establishing eligibility for coverage.

# APPENDIX "A"

## Advertising Checklist

# ADVERTISING CHECKLIST



PROVIDENT

1 Fountain Square  
Chattanooga, TN 37402

The Advertising Checklist provides guidance for preparing advertising prior to review. The Checklist is based on the most common state laws and rules governing advertising, but is not intended to be exhaustive. Any advertising that includes misleading statements is unacceptable.

**Note:** Advertising used in certain states must meet additional requirements.

If you cannot answer "Yes or Not Applicable" to each item, you should revise the advertising prior to submission.

Yes  
or  
N/A

## GENERAL

- ☐ The advertising is identified with a unique form number. (Obtained from Market Communications.)
- ☐ All statements and illustrations are accurate.
- ☐ The advertising would not be misleading to the average person who has no previous knowledge of insurance concepts.

## COMPANY INFORMATION

- ☐ The full name of the issuing company (e.g., Provident Life and Accident Insurance Company) is used in the first reference to the Company in the text and/or prominently displayed.
- ☐ Initials are not used in place of the issuing company name.
- ☐ The full Home Office address is included:

1 Fountain Square  
Chattanooga, TN 37402

or

18 Chestnut Street  
Worcester, MA 01608

- ☐ Ratings are not used unless the purpose, meaning, and limitations of the ratings are clearly indicated.

Yes  
or  
N/A

### COMPANY INFORMATION (continued)

- ☐ If capital or assets are disclosed, then liabilities (as disclosed in the latest annual report) are disclosed in equal prominence. Assets are not mentioned alone.
- ☐ References to "Provident" do not imply that Provident Companies guarantees the products or contractual obligations of the issuing company and are not misleading as to the company issuing the product.
- ☐ No references are made to Risk Based Capital levels.
- ☐ No references are made to guaranty fund or association coverage.

### PRODUCT INFORMATION

- ☐ The type of insurance being offered is clearly identified (e.g., "term life insurance"). Additionally, the first time any specific product name is used, it is accompanied by a clear description of the type of policy or contract advertised (e.g., "universal life insurance").
- ☐ The product is identified as an insurance policy, and it is clear that insurance is the subject of solicitation.
- ☐ No representations exist that imply that premiums paid under a life insurance policy can be "withdrawn." (Instead, note that cash value is most often available for loans or surrender/withdrawals, which may be subject to penalties/maximums.)
- ☐ It is clearly stated that loans and surrenders may reduce the value of a life insurance policy and that charges apply to loans and surrenders.
- ☐ If there is a reference to any dollar amount of benefits, period of time for which benefits are payable, specific policy benefits, or losses for which benefits are payable, there is also a discussion of all exceptions, reductions and limitations affecting benefit payment, including disclosure of the extent to which pre-existing conditions are not covered.
- ☐ The term "vanishing premium" (or any variation thereof) is not used.
- ☐ The terms "non-medical" or "no medical examination required" are not used unless it is also stated that issuance of the policy depends upon answers in the application. (If pre-existing conditions are not covered, these terms may not be used at all.)

Yes  
or  
N/A

### MISCELLANEOUS

- ☐ Citations for the sources of all statistical information are provided.
- ☐ Testimonials or endorsements by third parties are not used unless they are genuine and pertinent to the product or service being advertised. It has been disclosed whether the endorsement has been paid for or whether the endorsee has financial interest.
- ☐ Approval or endorsement of a policy by a group, society or association is not stated or implied, unless true.
- ☐ There are no unfair or inaccurate comparisons of policies, benefits, performance or rates of other insurers or their products. Comparisons are complete and disclose all salient features, not just those that show the Company's product in a favorable light.
- ☐ A competitor, its products, or its methods of selling has not been disparaged.

### PRODUCER INFORMATION

- ☐ Producer is identified as a Producer of the appropriate issuing company.
- ☐ Producer has indicated appropriate designations or licenses (e.g., CLU) in conjunction with identification as a Producer of the Company.
- ☐ No reference to a Producer's status as a "financial planner," "financial consultant," or "investment advisor" appears in the advertising.
- ☐ The Producer's agency name used does not obscure the fact that insurance is being sold.
- ☐ For client mailers, there is a statement notifying the client that a Producer may contact him or her regarding the offer of insurance, if such is the case.

Exhibit D  
Results of Complaint Testing

Insured	State	How many working days did it take the Company to respond?	Response is within the time required or requested by the DOI if applicable.	The Company maintains adequate documentation in the complaint file.	The Company responded in a manner that fully addressed the issue.	Were Company procedures followed?	If complaint is due to denial of claim, was a specific reason cited as per policy provisions?	Does the letter from the Company contain "contact information" ? (toll-free, or individual etc.)
[REDACTED]	TX	11	No -A	Yes	Yes	No	Yes	No- B
[REDACTED]	PA	12	Yes	Yes	No	No	Yes	Yes
[REDACTED]	CA	9	Yes	Yes	No	Yes	N/A	No - D
[REDACTED]	AR	8	No	Yes	Yes	Yes	Yes	No - D
[REDACTED]	CN	93	No	Yes	No	No	Yes	Yes
[REDACTED]	TX	27	No	Yes	No	No	N/A	No - C
[REDACTED]	AL	12	No	Yes	Yes	No	Yes	Yes
[REDACTED]	CA	9	Yes	Yes	No	Yes	N/A	Yes
[REDACTED]	TX	12	No	Yes	Yes	No	Yes	Yes
[REDACTED]	GA	6	Yes	No	No	Yes	N/A	Yes
[REDACTED]	IL	5	Yes	Yes	Yes	Yes	No	Yes
[REDACTED]	NY	11	Yes	Yes	Yes	No	N/A	Yes
[REDACTED]	NY	22	No	Yes	Yes	No	N/A	Yes
[REDACTED]	GA	4	Yes	No	N/A	Yes	N/A	Yes
[REDACTED]	NI	13	Yes	Yes	Yes	No	N/A	Yes
[REDACTED]	MS	19	No	Yes	Yes	No	No	Yes
[REDACTED]	OH	7	Yes	Yes	No	Yes	Yes	Yes
[REDACTED]	MO	1	N/A	Yes	No	Yes	Yes	Yes
[REDACTED]	CA	20	Yes	Yes	Yes	No	N/A	Yes
[REDACTED]	WA	25	No	Yes	Yes	No	Yes	No
[REDACTED]	CO	7	N/A	No	No	Yes	No	No
[REDACTED]	CA	17	No	No	Yes	No	No	Yes
[REDACTED]	CN	16	N/A	Yes	Yes	No	Yes	Yes
[REDACTED]	MA	9	Yes	No	No	Yes	No	Yes
[REDACTED]	CA	32	No	Yes	Yes	No	Yes	Yes
[REDACTED]	CA	15	N/A	Yes	Yes	Yes	No	Yes
[REDACTED]	CA	9	N/A	No	Yes	Yes	No	Yes
[REDACTED]	VA	15	Yes	Yes	Yes	No	Yes	Yes

Explanation of Lettered Notes:

A. The file documents a request was made to the DOI for an extension of time to provide a response to the complaint.

B. A response letter from Provident to the DOI did provide a toll-free telephone number. However, the notices sent to the insured did not include a telephone number for further inquiries, 1-800 or otherwise.

C. The response letter sent to the DOI did not contain a contact phone number. However, notices sent to insured did contain a 1-800 number for contact.

D. The final determination letter did not contain a phone number for insured inquiries.

Exhibit E  
Claim Handling Complaint Summary

Insured	Summary of Complaint
[REDACTED]	<p>A termination of benefits notice was sent to the insured on the basis that he was not actively under treatment. However, the insured stated that he could not afford to see a doctor more frequently, (his medical insurance was terminated). The insured's doctor was sending monthly notices to the Company confirming his continued disability. File documentation does not indicate that an IME was conducted prior to the termination of benefits. The IME was only scheduled after receipt of a Department of Insurance complaint. Based on results of the IME, the Company re-instated the benefits.</p>
[REDACTED]	<p>The insured's disability benefits were terminated based on exhaustion of the policy benefit for sickness. The insured stated that his spinal stenosis was not a sickness, rather a traumatic injury (due to repeated back trauma sustained as an emergency room doctor) and wanted benefits paid under the injury category, for which there is a life-time disability benefit. The response to insured did not define injury or sickness, and simply stated that insured's condition was classified as a sickness and therefore, no further benefits were payable.</p>
[REDACTED]	<p>The insured complained about the Company overstepping its contractual rights. His complaints included the Company's sharing of the IME report with his treating physician, and attempts to dictate treatment.</p>
[REDACTED]	<p>Extensive documentation was in the file. The insured alleged that the agent recommended delaying the claim report. This issue was never addressed by the Company. The letter to the insured stated that the notice of claim must be given within 30 days from the date a claim arises, and that proof of the claim must be received within 90 days of this date. Specific policy language was not quoted. The Company stated that conditions of the contract do not permit consideration of benefits to July 1996 since notice and proof of the alleged onset of disability were not provided. The Company was only willing to evaluate the claim from 90 days prior to the filing of the first notice of the claim, which commenced the one year elimination period in October 96 and provided benefits for continued disability only after October 1997.</p>
[REDACTED]	<p>The insured sent the complaint to the Department of Insurance. It was obvious from his correspondence there was some lack of communication with the Company. The insured expressed frustration and stated interest in pursuing and resolving his claim. The Company response failed to address the issues raised by insured in his letter, and only reiterated the company position, stating that future information was previously requested, and that the file would remain closed until this information has been received.</p>
[REDACTED]	<p>The insured was a surgeon whose hand surgery left him unable to perform operations. The insured's benefits were terminated when the Company discovered that he was listed as attending physician on an operative report from the VA training hospital where he was employed. The insured was displeased because the Company did not fully investigate this matter before terminating his benefits. The insured disputed the Company's contention that he performed surgery. (The facility was a teaching hospital, and the insured reported that residents could not be listed as attending physicians on operative reports). The Company response to Department of Insurance reported that clarification was requested from the insured, but the insured instituted suit. The Company was unable to release further information to the Department of Insurance because of this.</p>
[REDACTED]	<p>Insured had been employed as a Certified Registered Nurse Anesthetist and had suffered an anterior cruciate ligament tear. The insured reported she was unable to work and was laid off. The Company's investigation showed the insured had voluntarily resigned from her position. Documentation supplied by insured supported her contention that she was unable to work. The file contains references to a compromise lump sum settlement that was offered to the insured.</p>

Exhibit E  
Claim Handling Complaint Summary

Insured	Summary of Complaint
[REDACTED]	The insured complained that she was unhappy with the lump sum settlement that was being offered. The file documentation indicates that an agreement was reached with the insured, and a settlement was made. The file does not contain specifics regarding the settlement agreement.
[REDACTED]	This file involves a claim for disability based on psychological reasons. The insured's correspondence references claims dating from August 1982 and November 1996. (It was not clear from his correspondence what the significance was of these two claims.) The Company response to the insured's complaint references a doctor's report which concluded that the insured was not disabled from performing the substantial and material duties of his occupation. The Company response further stated that Company was in the process of scheduling an IME. The Company's response did not address the issues raised by the insured regarding outstanding payments and other issues mentioned in his letter.
[REDACTED]	The insured reported to the Department of Insurance that he had been receiving benefits, but for some unspecified reason, the Company was no longer issuing payments. In response to the Department of Insurance, the Company sent a response letter reporting that a settlement agreement had been reached with the insured, and that a check had been processed. No details were given in the file regarding the specifics of the settlement agreement.
[REDACTED]	Prior to his disability, the insured had been employed as a district manager for laundry and dry cleaning business. His claim was denied based on a review conducted by the in-house medical consultant and the findings of labor market survey conducted by the Company's vocational rehabilitation consultant. The labor market survey did not appear to support Company's contention that the insured was not totally disabled.
[REDACTED]	The claimant voluntarily left employment as management of a rental car agency due to difficulties concentrating, etc. The problem was later found to be due to bipolar disorder. The Claimant had in the meantime begun work at a part time less stressful job. Once it was confirmed (3 years later) that the problem was bipolar disorder, a claim was filed. The insured's claim was denied due to "definition of disability" related to "own occupation" which the Provident now considers the part-time job. There was no reference in the letter to any time period within which the claim needed to be filed. [The policy which provided coverage to the insured defined notice of claim to be as soon as reasonably possible. With regard to proof of loss policy provisions, this policy stated, "If it was not reasonably possible for you to give written proof in the time required, we will not reduce or deny the claim for this reason if the proof is filed as soon as reasonably possible." ] <i>This file is now in litigation.</i>
[REDACTED]	The claimant believes that Provident should pay the increased benefit per the policy rider due to a separate condition causing disability. The Company position was upheld due to policy provisions regarding continuous disability. However, the Company was not as timely with follow-up information as requested. When the entire file was supplied to the CA Department of Insurance, the Department of Insurance considered the claim in error and Provident finally agreed. A request was made for Provident to respond to allegations of Unfair Claim Settlement Practices. The Company addressed the problem, paid additional benefits and no further action was taken by the CA Department of Insurance.



Exhibit E  
Claim Handling Complaint Summary

Insured	Summary of Complaint
[REDACTED]	The original determination was made in the favor of the claimant. However, a letter requiring an IME was also sent on the same day. The claimant was upset by this and submitted a complaint. The claimant refused to supply new address, etc and the Company terminated the insured's benefits based on file documentation. The Claimant rebutted the facts in a letter stating the information was never requested. The file documentation appears to support this. A letter was sent back to the insured stating that an IME would be performed after the claimant had moved and that benefits would be suspended until that time.
[REDACTED]	The claimant alleged unfair treatment, harassment and payment delays. The Company responded with dates of payment that appeared quite prompt. The California Department of Insurance alleged violations of California Fair Claims Settlement Practices.
[REDACTED]	The doctor used by the Company disagreed with the claimant regarding his ability to return to work. The company is paying benefits for three months pending additional information. The Claimant also alleged that his correspondence has been ignored. The company continually maintained their decision to deny further benefits.
[REDACTED]	Claimant wanted to receive benefits, but the company could not get cooperation from the doctors involved. A settlement was reached between company and claimant.
[REDACTED]	The claimant's benefits were suspended due to lack of documentation. The Company gave the claimant many chances to supply this. They were supplied and it was discovered that the mental condition of the patient manifested itself well before the policy was in force. The policy effective date was 2/1/90, the incontestability clause over 2/1/92. It appears that the claim was made and work terminated sometime in 1993. <i>This file is now in litigation.</i>
[REDACTED]	The claimant has dispute due to paperwork given her as to when the policy was in effect. Further, she states that pre-existing exclusion does not apply as she is suffering now from preeclampsia which did not pre-date the policy by 6 months- normal pregnancy before then. The Company's position was reversed and the claim was paid.
[REDACTED]	The claimant felt he was entitled to more benefits but the company contended that benefits were correctly calculated. The VA Department of Insurance then requested further information as the enrollment card did not seem to match the premium and benefit he actually had. The BOI required the payment to be made as illustrated in the enrollment and to check all other enrollments at that employer.

